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Phones
41504444, 45341000

Fax
011-24626727

Website
www.icsi.edu

E-mail
info@icsi.edu
Corporate Governance has emerged as an important academic discipline in its own right, bringing together contributions from accounting, finance, law and management. Corporate governance now 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. Excellence can be bettered only through continuous study, research and academic and professional interaction of the highest quality in the theory and practice of good corporate governance. The corporate world looks upon especially Company Secretaries to provide the impetus, guidance and direction for achieving world-class corporate governance.

Company Secretaries are the primary source of advice on the conduct of business. This can take into its fold everything from legal advice on conflicts of interest, through accounting advice, to the development of strategy/corporate compliance and advice on sustainability aspects.

The paper on Ethics, Governance and Sustainability has been introduced to provide knowledge on global development on governance, ethics and sustainability aspects and best governance practices followed worldwide.

This paper would help in understanding of national and international governance norms, ethical business practices, corporate sustainability, CSR and sustainability reporting, role of various governance forums etc.

The study material is based on those sections of the Companies Act, 2013 and the rules made there under which have been notified by the Government of India and came into force w.e.f. April 01, 2014 (including Amendments/Clarifications/Circulars issued there under upto January 2016). In respect of sections of the Companies Act, 2013 which have not been notified, applicable sections of Companies Act, 1956 have been dealt with in the study. The study material is also updated as per SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015. This study has also been updated as per the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015. Further students are advised to keep themselves abreast of latest developments on governance and sustainability issues by regularly reading economic dailies and visiting the websites of regulatory bodies, national and international corporate governance forums. Students are also advised to read regularly the ‘Student Company Secretary’/‘Chartered Secretary’ wherein all important regulatory amendments are reported regularly.

In the event of any doubt, students may write to Directorate of Academics in the Institute for clarification at academics@icsi.edu. Although due care has been taken in publishing this study material, yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

Should there be any discrepancy, error or omission in the study material, the Institute shall be obliged if the same is brought to its notice for issue of corrigendum in the Student Company Secretary.
## PROFESSIONAL PROGRAMME

### SYLLABUS

**FOR**

### MODULE 2 – PAPER 6: ETHICS, GOVERNANCE AND SUSTAINABILITY (100 Marks)

**Level of Knowledge:** Advance Knowledge

**Objective:** To acquire knowledge of ethics, emerging trends in good governance practices and sustainability.

**Contents:**

### Part A: Ethics and Governance (70 Marks)

1. **Introduction**
   - Ethics, Business Ethics, Corporate Governance, Governance through Inner Consciousness and Sustainability
   - Failure of Governance and its Consequences

2. **Ethical Principles in Business**
   - Role of Board of Directors
   - Organization Climate and Structure and Ethics
   - Addressing Ethical Dilemmas
   - Code of Ethics; Ethics Committee; Ethics Training; Integrity Pact
   - Case Studies and Contemporary Developments

3. **Conceptual Framework of Corporate Governance**
   - Introduction, Need and Scope
   - Evolution of Corporate Governance
   - Developments in India
   - Developments in Corporate Governance – A Global Perspective
   - Elements of Good Corporate Governance

4. **Board Effectiveness - Issues and Challenges**
   - Board Composition; Diversity in Board Room; Types of Directors; Board’s Role and Responsibilities
   - Chairman, CEO, Separation of Roles
   - Relationship between Directors and Executives
   - Visionary Leadership
5. Board Committees

- Introduction
- Various Board Committees, their Composition, Role and Responsibilities, Contribution to Board Governance
  - Audit Committee
  - Shareholders Grievance Committee
  - Remuneration Committee
  - Nomination Committee
  - Corporate Governance Committee
  - Corporate Compliance Committee
  - Other Committees

6. Legislative Framework of Corporate Governance in India

- Under Listing Agreement, SEBI Guidelines, Companies Act
- Corporate Governance in
  - PSUs
  - Banks
  - Insurance Companies

7. Legislative Framework of Corporate Governance – An International Perspective

- Australia
- Singapore
- South Africa
- United Kingdom
- Contemporary Developments in the Global Arena

8. Risk Management and Internal Control

- Risk and its Classification
- Risk Management and Oversight
- Enterprise Risk Management
- Internal Control
- Roles and Responsibilities of Internal Control
- Disclosure about Risk, Risk Management and Internal Control
### 9. Corporate Governance and Shareholder Rights
- Rights of Shareholders
- Challenges in Exercising Shareholders Rights
- Corporate Governance issues with regard to Related Party Transactions
- Role of Investor Associations in Securing Shareholders Rights
- Role of Institutional Investors in Corporate Governance

### 10. Corporate Governance and Other Stakeholders
- Employees
- Customers
- Lenders
- Vendors
- Government
- Society

### 11. Corporate Governance Forums
- The Institute of Company Secretaries of India
- National Foundation for Corporate Governance
- Organisation for Economic Co-operation and Development
- Global Corporate Governance Forum
- Institute of Directors
- Commonwealth Association of Corporate Governance
- International Corporate Governance Network
- The European Corporate Governance Institute
- Conference Board
- The Asian Corporate Governance Association
- Corporate Secretaries International Association

### Part B: Sustainability (30 Marks)

### 12. Sustainability
- Meaning and Scope
- Corporate Social Responsibility and Corporate Sustainability
- Sustainability Terminologies and Meanings
- Why is Sustainability an Imperative
- Sustainability Case Studies
- Triple Bottom Line (TBL)
13. Corporate Sustainability Reporting Frameworks

- Global Reporting Initiative Guidelines
- National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business
- International Standards
- Sustainability Indices
- Principles of Responsible Investment
- Challenges in Mainstreaming Sustainability Reporting
- Sustainability Reporting Case Studies

14. Legal Framework, Conventions, Treaties on Environmental and Social Aspects

15. Principle of Absolute Liability – Case Studies

16. Contemporary Developments – Integrated Reporting
LIST OF RECOMMENDED BOOKS

MODULE 2

PAPER 6: ETHICS, GOVERNANCE AND SUSTAINABILITY

2. Corporate Governance, Principles, policies and Practices – A.C. Fernando, Pearson Education
3. Corporate Governance – IICA, Taxmann
4. The Art of Corporate Governance – Dr. Joffy George
5. Journals- (a) ICSI – Chartered Secretary
   (b) ICSI – Student Company Secretary – E-bulletin
6. Companies Act 2013 and Rules
7. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
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Lesson 1
Introduction: Ethics and Governance

LESSON OUTLINE

- Introduction
- Governance through Inner conscience
- Ethics
- Ethics in Business
- Corporate Governance Ethics
- Theories of Ethics
- Scope of Business Ethics
- Advantages of Business Ethics
- Conclusion
- 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
- The ethics philosophy
- Scope of Business Ethics in
  - Compliance
  - Finance
  - Human Resources
  - Marketing
  - Production
- Advantages of Ethics

“Ethics is knowing the difference between what you have a right to do and what is right to do.”

-Potter Stewart
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.

GOVERNANCE THROUGH INNER CONSCIENCE

To be able to do the right thing in the right way, in each case and at every moment, one must be in the right consciousness.

-Sri Aurobindo

Inner consciousness is the awareness, the capacity to listen to the inner voice that tells us that there is someone who is looking up at us and also warns that there is someone who is watching us. The soul and core of Corporate Governance is not the conduct or behavior that we see outwardly. The soul and core of Corporate Governance is what our inner conscience is like. It is internalized values that an organization and its top management follow.

The essence of a human being is consciousness and the world we create around us is the expression of our consciousness. The creative and the beautiful as well as the corrupt and degenerate are the outcome of our consciousness. The great thoughts and deeds of Mahatma Gandhi or Mother Teresa are the result of their consciousness. Similarly, the scams of WorldCom and Satyam are also the result of corresponding consciousness. The quality of our consciousness is not determined by the Intelligence Quotient or our intellect.

The quality of our consciousness depends on the part of the consciousness in which we live. There are two parts in our consciousness. First is the lower physical-vital being driven predominantly by self-interest, material needs and sensual desires, quite often degenerating into greed. The second is the higher mental, moral and spiritual being seeking for truth, beauty, goodness, harmony and unity. The corporate governance, to be truly effective and enduring, has to be based on this higher part of our human nature or conscience.

An important quality of this higher part of our conscience is self-governance. This higher self in us doesn’t need the threat of external Law or the lure of an external reward to remain good or ethical; it has an intrinsic motivation for ethics and self-regulation. This ideal of self-governance must be the highest goal of all governance. Self-governing Individual in a self-governing community must be the highest ideal of corporate governance. We are, individually and collectively, still far away from this ideal. We still need laws because we are not yet ready for self-governance. But we must keep this ideal as a pole-star and gradually progress or evolve towards it through a combination of enlightened regulation of the external environment and inner transformation through education and inner discipline.

Ideally, corporate governance should endeavour to create corporate consciousness and an environment in which those who are charged with governance and those who are governed display genuine ethical, social and ecological responsibilities.

ETHICS

The term “ethics” is derived from the Greek word “ethos” which refers to character, guiding beliefs, standards and ideals that pervade a group, a community or people. The Oxford Dictionary states ethics as “the moral principle that governs a person’s behaviour or how an activity is conducted”. The
synonyms of ethics as per Collins Thesaurus are – conscience, moral code, morality, moral philosophy, moral values, principles, rules of conduct and standards.

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.

In bygone times, kings used to keep food testers who used to eat the food prepared for the king before it was offered to him. This was royal clinical research to find out if the food was poisoned. This practice was not questioned because the king was regarded as the most important person in the kingdom, and his life was more precious than that of anyone else. It was the ethics of the time.

What is considered ethical behaviour in one society might be considered unethical in another. For example, euthanasia (mercy killing) is permitted in some countries but it is considered strictly unethical in most countries.

Ethics has following features:

→ Ethics is a conception of right or wrong conduct. Ethics tells us when our behaviour is moral and when it is immoral. It deals with the fundamental human relationship, how we think and behave towards others and how we want them to think and behave towards us.

→ Ethics relates to the formalised principles derived from social values. It deals with the moral choices that we make in the course of performing our duties with regard to the other members of society. Hence, it is relevant in the context of a society only.

→ Ethical principles are universal in nature. They prescribe obligations and virtues for everybody in a society. They are important not only in business and politics but in every human endeavour.

→ There exist no sharp boundaries between ethical and non-ethical. Therefore, people often face ethical dilemmas wherein a clear cut choice becomes very difficult.

→ The concepts of equity and justice are implicit in ethics. Fair and equitable treatment to all is its primary aim.

→ Ethics and legality of action do not necessarily coincide. What a society interprets as ethical or unethical ends up expressed in laws. The legality of actions and decisions does not necessarily make them ethical. For example, not helping an injured person in a road accident may be unethical but not illegal.

ETHICS IN BUSINESS

The Concept of Business Ethics

Business ethics is one of the important branches of applied ethics. Business ethics is the application of general ethical ideas to business. “Business ethics refers to the moral principles and standards and a code of conduct that businessmen are expected to follow while dealing with others. Business essentially is a means of society to use scarce resources to produce in an efficient manner those goods and services which society wants and is willing to pay for. Businesses must balance their desire to maximise profits against the needs of stakeholders. The significant issues in business ethics include ethical
management of enterprise in relation to its stakeholders in particular and natural environment in
general.

Ethics is necessary and important in business due to several reasons, some of which are given below:

• There is a kind of social contract between the society and business by which the society
  expects the business to work in its interest. Society creates and accepts business enterprises,
  hence it expects them to work in a manner which is not detrimental to its well being and
  interests. Technological advancements have to be made but their impact on the environment
  and mankind has he kept in mind.

• Ethical conduct is in the long-term interests of businessmen. A business enterprise that is
  honest and fair to its customers, employees, and other stakeholders earns their trust and good
  will. It ultimately results in customer satisfaction, healthy competition, industrial growth and high
  earnings. Businesses must balance their desire to maximise profits against the requirements of
  stakeholders. Maintaining this balance often requires trade offs. To address this unique aspect
  of business, rules are articulated to guide it to earn profits without harming individuals or society
  as a whole. While referring to business activity profile, Mahatma Gandhi once mentioned that all
  business entrepreneurs should ask themselves the question whether the activities they are
  contemplating would be of some use to the common man. This statement emphasizes the
  importance of nobility of business purpose.

• Ethical business behaviour is not only about good business but about good citizenship as well.
  Morally conscious businessmen have created names and built great business empires. They
  serve customers with good quality products at fair prices, treat their employees with great
  respect, reward their shareholders with good returns and pay their taxes honestly.

• Ethical policies and practices enable a business enterprise to build goodwill for itself. A
  business organisation that adheres to a code of conduct gains a competitive advantage and
  builds long term value. On the other hand, unethical practices lead to the ultimate downfall of
  big organisations too.

• Business can prosper only when a society is stable and peaceful. Unethical practices at times
  create distrust, disorder and turmoil in society.

Business ethics refers to a ‘code of conduct’ which businessmen are expected to follow while dealing
with others. ‘Code of conduct’ is a set of principles and expectations that are considered binding on any
person who is member of a particular group. The alternative names for code of conduct are ‘code of
ethics’ and ‘code of practice’.

Business ethics comprises of the principles and standards that guide behaviour in the conduct of
business. Businesses must balance their desire to maximize profits against the needs of the
stakeholders. Maintaining this balance often requires tradeoffs. To address these unique aspects of
businesses, articulated as well as implicit rules are developed to guide the businesses to earn profits
without harming individuals or society as a whole.

The coverage of business ethics is very wide as it deals with norms relating to a company and its
employees, suppliers, customers and neighbors, its fiduciary responsibility to its shareholders. It reflects
the philosophy of business, one of whose aims is to determine the fundamental purposes of a company.

Business ethics stands for the saneness or purity of purpose that is upheld through carefully designed
actual practices of business enterprises. It is an embodiment of conscious concern towards execution of
business processes in tune with the nobility of the purpose.
While referring to business activities, Mahatma Gandhi once mentioned that all businesses have a social responsibility which has nothing to do with its ordinary economic activity. For instance, if there is a natural calamity in an area adjoining a business organisation, the society would expect the business to participate in the relief work. Such a social responsibility arises out of ethical considerations and not out of profit-making considerations. Therefore, the responsibility towards society is a moral obligation arising out of business ethics, which in turn is steeped in the philosophy of business.

**CORPORATE GOVERNANCE ETHICS**

Business ethics and corporate governance of an organization go hand in hand. In fact, an organization that follows ethical practices in all its activities will, in all probability, follow best corporate governance practices as well.

Corporate governance is meant to run companies ethically in a manner such that all stakeholders including creditors, distributors, customers, employees, the society at large, governments and even competitors are dealt with in a fair manner. Good corporate governance should look at all stakeholders and not just the shareholders alone.

Corporate governance is not something which regulators have to impose on a management, it should come from within.

A business organization has to compete for a share in the global market on its own internal strength, in particular on the strength of its human resource, and on the goodwill of its other stakeholders. While its stat-of-the-art technologies and high level managerial competencies could be of help in meeting the quality, cost, volume, speed and breakeven requirements of the highly competitive global market, it is the value-based management and ethics that the organization has to use in its governance. This would enable the organization to establish productive relationship with its internal customers and lasting business relationship with its external customers.

**THEORIES OF ETHICS**

**Ethical Theories**

Ethical theories arise in different contexts, so they address different problems. They also represent some ethical principles. There are many ethical theories but in general there are two major kinds of ethical theories: Deontological and Teleological ethical theories. Broadly speaking Deontological theories emphasise on consequences, whereas Deontological theories are interested more in duty.

**Deontological Theories – Kantian Ethics**

Deontologic theories of ethics are different from utilitarian theories of ethics. According to Deontological theories, though the consequences of an act is good, some acts are always wrong. In deontological theories actions are judged as ethical or unethical based on duty or intentions of an actor. The most important defender of deontological ethics is Immanuel Kant who forward his moral theory in 1788.

Kant's ethical theory includes duty without regard to human happiness. His moral theory is based on his view of the human being as having the unique capacity for rationality. No other animal possesses such a propensity for reasoned thought and action, and it is exactly this ability which obliges us to act according to the moral law / duty. Kant's moral theory emphasises acting in accordance with and for the sake of duty. Kant believed that inclinations, emotions and consequences should play no role in moral action. This means that motivation for action must be based on obligation. Morality should provide us with a framework of rational principles (rules) that guide and restrict action, independent of personal intentions and desires.
It is worth mentioning that another divergence between the theories of utility and deontology is the way in which they are constructed: utilitarianism is concerned with actively maximising the good while deontology is more negatively focused on avoiding the morally impermissible (or on the constraints of action).

The moral worth of an action is determined by the will. The human will is the only thing in the world that can be considered good without qualification, according to Kant. Good will is exercised by acting according to moral duty/law. The moral consists of a set of moral maxims which are categorical in nature.

According to Kant, every action has a maxim. Maxim means rule of principle. He tries to provide a universal law that is true under any circumstances for everyone. It can be concluded that deontological ethics based on Kantian ethics emphasises a universal morality. The principle of deontological ethics can be summed up in the phrase, “treat others as you would be treated”.

Kant distinguishes two kinds of imperatives; hypothetical and categorical imperatives. Hypothetical imperatives are conditional, whereas categorical imperatives are unconditional and they must be obeyed under any conditions. Hence, according to Kantian ethics, is an action passes the test of categorical imperative, the action is ethical. It can be claimed that categorical imperative rules out some certain practices, such as theft, fraud, coercion and so on in business life. If Kantian ethics can be applied in business life, it provides universal place in business world.

Teleological Theories

Teleology is derived from the Greek word ‘telos’ meaning ends or purposes. This theory holds that ends or consequences of an act determine whether the act is good or bad. Rightness of actions is determined solely by their good consequences. Teleological approach is also known as consequential ethics.

Businessmen commonly think in terms of purposeful actions as in, for example, management by objectives. Teleological analysis of business ethics leads to the consideration of the full range of stakeholders in any business decision, including the management, the staff, the customers, the shareholders, the country, humanity and environment.

Utilitarian Approach

Utilitarianism is an ethics of welfare. Business guided by utilitarian approach focuses on behaviours and their results, not on the means of such actions. It can be described by the phrase, “the greatest good for the greatest number.” The utilitarian approach prescribes ethical standards for managers in the areas of organisational goals, i.e., maximisation of profits; and having efficiency which denotes optimum utilization of scarce resource.

Utilitarianism prescribes that the moral worth of an action is solely determined by its contribution to overall utility, that is, its contribution to the happiness and satisfaction of the greatest member. For example, one may be tempted to steal from a rich wastrel to give to a starving family. Hence, this approach is also referred as consequential approach. Utilitarianism is a general term for any view that holds that actions and policies should be evaluated on the basis of the benefits and costs they impose on the society. The policy which produces the greatest net benefit on lowest net costs is considered right.

The best way to analyse any decision including a business decision is by doing a cost benefit analysis. Several government agencies, legal theorists and moralists advocate utilitarianism.
Jeremy Bentham is considered as the founder of traditional utilitarianism. He propagates on objective basis for making value judgements that would provide common acceptable norm for determining social policy and social legislation.

The utilitarian principle states, “an action is right from ethical print of view if and only if the seem total of utilities produced by that act are greater than the sum total of utilities produced by any other act that can be performed at that point of time by any person”. This approach gives precedence to good over right.

There are some limitations utilitarian approach. It is impossible to measure utility of different actions on a common scale. How can utility of one action be compared to that of the other? At times benefits and cost of an action cannot be even predicted accurately. For example, it is not possible to predict advantages of building housing for the underprivileged. Moreover, non-economic goods, such as life, equality, health, beauty and justice cannot be traded for economic goods. But utilitarianism assumes that all goods are tradable for some quantity of another good.

Both Utilitarianism and Kantian ethics have important implications in business world. Therefore, both of them can be applied in business ethics. However, both have some negative points. Some are of the view that utilitarian ethics is more applicable to business ethics than Kantian ethics, because the aim of any business is to gain profit/benefit. The fundamental feature of utilitarianism is to maximize utility.

**Virtue Theory**

Virtue theory of ethics is a very old concept existing since the time of Aristotle (384BC), and there are a variety of theories that fall under the category of virtue theory. It is, firstly, important to understand what is meant by virtue – it is a slightly old – fashioned term. Whereas the other normative theories attempt to answer the question of ‘the right action’ (or ethical behaviour), virtue theory is more concerned with answering the question of how to live a good life or how to be a good person. Virtue theory aims to offer an account of the characteristics one must have to be considered virtuous.

**The Emergence of Modern Virtue Theory**

Virtue theory went out of favour with the advent of Kantianism and Utilitarianism. However, it re-emerged in 1958 with the publication of paper entitled “Modern Moral Philosophy” by Elizabeth.

According to Aristotle, “role of ethics is to enable us to lead a successful and good life”. This in Aristotle's view is possible only for virtuous people. In his words “virtue is a character trait that manifests itself in habitual action”. For example, honesty does not imply telling the truth once but has to be the trait of a person who tells the truth as general practice. Thus, we can define virtue as a trait of character, that is essential for leading a successful life. Aristotle considers pride and shame to be virtues on the grounds that we should be proud of our accomplishments and ashamed of our failings. Virtues should contribute to the idea of a good life. They are not merely means to happiness but are constituents of it.

The virtues of successful living apply to business as well. But everyday life virtues cannot be applied to business unconditionally. Any manager while looking at employee welfare cannot always avoid layoff. Certain amount of concealment is justified and acceptable in business negotiations. Therefore, applying virtue ethics to business would require determining the end at which business activity aims. Hence, honesty in business is not necessarily the same as honesty in other spheres of life. Whether any trait is a virtue in business is to be determined by the purpose of business and by the extent to which that trait contributes to that purpose.
Justice Theory

Justice approach is also known as fairness approach. Greek philosophers have contributed to the idea that all equals should be treated equally. Justice does not depend on consequences; it depends on the principle of equality.

The contemporary American Philosopher John Rawl's objection to utilitarianism is that it does not give adequate attention to the way in which utility is distributed among different individuals. As an alternative to the utilitarian idea of society with highest welfare, Rawls proposes a society that recognizes its members as free and equal person who attempt to advance their own interests and come into conflict with others pursuing their self interests.

The key to a well-ordered society is the creation of institutions that enable individuals with conflicting ends to interact in mutually beneficial ways. The focus here is on social justice. Rawls promotes “Play It Safe”. He argues that a rational person should choose the alternative in which the worst possible outcome is still better than the worst possible outcome of any other alternative.

Theory of Egoism

Egoism is derived from the Latin word 'ego' meaning 'I'. The theory of egoism holds that the good is based on the pursuit of self-interest. This model takes into account harms, benefits and rights for a person’s own welfare. Under this model an action is morally correct if it increases benefits for the individual in a way that does not intentionally hurt others, and if these benefits are believed to counterbalance any unintentional harms that ensue. For example, a company provides scholarships for education to needy students with a condition that the beneficiary is required to compulsorily work for the company for a period of 5 years. Although, the company is providing scholarship benefits to the needy students, ultimately it is in the company’s self interest.

Theory of Relativism

Theory of Relativism promotes the idea that some elements or aspects of experience or culture are relative to, i.e., dependent on, other elements or aspects. It holds that there are no absolute truths in ethics and that what is morally right or wrong varies from person to person or from society to society. The term often refers to truth relativism, which is the doctrine that there is no absolute truth, i.e., that truth is always relative to some particular frame of reference, such as a society or a culture. For example, killing animals for sport (like bull fighting) could be right in one culture and wrong in another.

SCOPE OF BUSINESS ETHICS

Ethical problems and phenomena arise across all the functional areas of companies and at all levels within the company which are discussed below:

Ethics in Compliance

Compliance is about obeying and adhering to rules and authority. The motivation for being compliant could be to do the right thing out of the fear of being caught rather than a desire to abide by the law. An ethical climate in an organisation ensures that compliance with law is fuelled by a desire to abide by the laws. Organisations that value high ethical values comply with the laws not only in letter but go beyond what is stipulated or expected of them.

Ethics in Finance

The ethical issues in finance that companies and employees are confronted with include:

— In accounting – window dressing, misleading financial analysis.
— Related party transactions not at arm length
— Insider trading, securities fraud leading to manipulation of the financial markets.
— Executive compensation.
— Bribery, kickbacks, over billing of expenses and facilitation payments.
— Fake reimbursements.

**Case of an unethical practice**

Mr. A is a respected senior officer in the company. He enjoys all the benefits and perquisites from the company, including a car with a driver, medical facility and reimbursements of certain expenditures.

During the months of September, October and December it was observed that his telephonic reimbursements were on a rising note. From Rs. 500 p.m. it went up to Rs. 2500 p.m. The matter was reported and investigated. It was found that Mr. A has made arrangements with the Telephone Company to make a single bill for two telephone numbers at his residence.

The effect of a petty misappropriation especially at the top level trickles down to all levels.

**Ethics in Human Resources**

Human resource management (HRM) plays a decisive role in introducing and implementing ethical practices in an organisation. Ethics should be a pivotal issue for HR specialists. The ethics of human resource management (HRM) covers those ethical issues that arise around the employer-employee relationship, such as the rights and duties issues between the employer and employee.

The ethical issues faced by HRM include:

— Discrimination issues, i.e., discrimination on the bases of age, gender, race, religion, disabilities etc.
— Sexual harassment.
— Affirmative Action.
— Issues surrounding the representation of employees and the democratization of the workplace and trade unionisation.
— Issues affecting the privacy of the employee: workplace surveillance, drug testing, etc.
— Discrimination of whistle-blowers.
— Issues relating to the fairness of the employment contract and the balance of power between the employer and employee.
— Occupational safety and health issues.

Companies tend to shift economic risks onto the shoulders of their employees. The boom of performance-related pay system and flexible employment contracts are indicators of these newly established forms of shifting risk.

**Case of unethical practice**

A middle level executive, Mr. X, based in Delhi, opts for a 3 day training programme in Bangalore, which happens to be his hometown. He also applies leave for 3 days immediately following the training, which is granted to him.
Mr. X reaches the venue of the training. On the first day, he registers himself, takes the training kit, attends the training for two hours, befriends a dealing officer and arranges to have the presentations, etc. sent to him. He does not attend the training programme thereafter.

Mr. X sends a report of the training as soon as he returns. His reporting officer summons him and asks him where he was during the training. At first, Mr. X reacts in a defensive manner saying that he was at the training site. The reporting officer then tells him that the company, in order to extend the training to other employees as well had got in touch with the programme organizers requesting them for a one to one meeting with Mr. X already present there and were informed of his absence. When confronted with this, Mr. X admits that he had not attended the training programme.

**Ethics in Marketing**

Marketing ethics is that area of applied ethics which deals with the moral principles behind the operation and regulation of marketing. The issue of marketing ethics is not limited to the kind of products alone. It also deals with how such products are delivered to the customers. The ethical issues confronted in this area include:

- Pricing: price fixing, price discrimination and price skimming.
- Anti-competitive practices, like manipulation of supply, exclusive dealing arrangements and tying arrangements.
- Misleading advertisements.
- Contents of advertisements.
- Decision making.
- Children and marketing.
- Surrogate advertising: For example, many liquor firms carry advertisements of products, like apple juice, soda and water.
- Black markets and grey markets.

**Ethics in Production**

This area of business ethics deals with the duties of a company to ensure that their products and production processes do not cause harm to society at large. Some of the more acute dilemmas in this area arise out of the fact that there is usually a degree of danger in any product or its production process and it is difficult to define the degree of permissibility, since the degree of permissibility may depend on the changing state of preventative technologies or changing social perceptions of acceptable risk.

- Defective, addictive and inherently dangerous products and
- Ethical relations between the company and the environment include pollution, environmental ethics and carbon emissions trading.
- Ethical problems arising out of new technologies, for example, genetically modified food.
- Product testing ethics.

The most systematic approach to fostering ethical behavior in business is to build a corporate culture that would link ethical standards and business practices.
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 dedicately 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, companies’ policies cultivate teamwork, promote productivity and support employee-growth.

Retaining talented people is as big a challenge for the company as getting them in the first place. Work is a mean to an end for the employees and not an end in itself. The relationship with their employer must be a win-win situation in which their loyalty should not be taken for granted. Talented people will invest their energy and talent only in organizations with values and beliefs that matches their own. In order to achieve this equation, managers need to build culture, compensation and benefit packages, and career paths that reflect and foster certain shared values and beliefs.

2. Investor Loyalty

Investors are concerned about ethics, social responsibility and reputation of the company in which they invest. Investors are becoming more and more aware that an ethical climate provides a foundation for efficiency, productivity and profits. Relationship with any stakeholder, including investors, based on dependability, trust and commitment results in sustained loyalty.

3. Customer satisfaction

Customer satisfaction is a vital factor of a successful business strategy. Repeated purchases/orders and an enduring relationship with mutual respect is essential for the success of the company. The name of a company should evoke trust and respect among customers for enduring success. This is achieved by a company only when it adopts ethical practices. When a company with a belief in high ethical values is perceived as such, the crisis or mishaps along the way is tolerated by the customers as minor aberrations. Such companies are also guided by their ethics to survive a critical situation. Preferred values are identified and it is ensured that organizational behavior is aligned to those values. An organization with a strong ethical environment places its customers’ interests as foremost. Ethical conduct towards customers builds a strong competitive position for the company. It promotes a strong public image too.

4. Regulators

Business should act ethically not only to benefit itself and to build its reputation, but also for the benefit of its key stakeholders.

Regulators eye companies functioning ethically as responsible citizens. The regulator need not always monitor the functioning of the ethically sound company. Any organisation that acts within the confines of business ethics not only earns profit but also gains reputation publicly.
To summarise, companies that are responsive to employees’ needs have lower turnover in staff.

— Shareholders invest their money into a company and expect a certain level of return from that money in the form of dividends and/or capital growth.

— Customers pay for goods, give their loyalty and enhance a company’s reputation in return for goods or services that meet their needs.

— Employees provide their time, skills and energy in return for salary, bonus, career progression and experience.

**CONCLUSION**

In making ethics work in an organization it is important that there is synergy in vision statement, mission statement, core values, general business principles and the code of ethics. A commitment by corporate management to follow an ethical code of conduct confers a variety of benefits. An effective ethics programme requires continual reinforcement of strong values. Organisations are challenged with the task to make their employees live and imbibe their ethical codes and values. To ensure a right ethical climate, a right combination of spirit and structure is required.

Corporate Ethics is much needed to stress the importance of sustainability, social development, stakeholders and consumers satisfaction. It is an orientation to provide a valuable service instead of displaying more orientation for profits. Ethics, point out what is good and what is bad and also what is right or wrong. It brings to the notice of the business community the importance of honesty, sincerity and fairness which makes them alert and socially conscious. It reconciles conflicting interest of various sections of the society such as workers, shareholders, consumers, distributors, suppliers, competitors and government and thus, expedite a better relation between business and the society.

**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 term ethics has its origin from the Greek word “ethos”, which refers to character or customs or accepted behaviors.

- Deontological ethics or deontology (Greek: *(deon)* meaning ‘obligation’ or ‘duty’) is an approach to ethics that focuses on the rightness or wrongness of actions themselves, as opposed to the rightness or wrongness of the consequences of those actions.

- Teleology (Greek: *telos*: end, purpose) is the philosophical study of design and purpose.

- Enlightened-egoism. This model takes into account harms, benefits and rights.

- Utilitarianism is the idea that the moral worth of an action is solely determined by its contribution to overall utility.

- Relativism is the idea that some elements or aspects of experience or culture are relative to, i.e., dependent on, other elements or aspects.

- Justice is the concept of moral rightness in action or attitude; it is closely linked to fairness.

- Organisations that value high ethics comply with the laws not only in spirit but go beyond what is stipulated or expected of them.

- Human resource management (HRM) plays a decisive role in introducing and implementing ethics.
• Marketing ethics is the area of applied ethics which deals with the moral principles behind the operation and regulation of marketing.

• **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. Describe the different ethical philosophies.
2. Write short notes on Ethics in Finance and Ethics in Marketing.
3. Write short notes on:
   (a) Governance Through Inner Consciousness
   (b) Ethics in compliance.
4. What are the advantages of Business Ethics for an organization?
Lesson 2
Ethical Principles in Business

LESSON OUTLINE

• Organization Structure and Ethics
• Ethics Programme
• Code of Ethics
• Code of Conduct
• Model Code of Business Conduct & Ethics
• Credo
• Ethics Training and Communication
• Ethics Committee
• Integrity Pact
• Social and Ethical accounting
• Concept of Whistle-Blower/Vigil Mechanism
• Ethics Audit
• Ethical Dilemma
• Conclusion
• Lesson Round-Up
• Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand the relationship between organizational values and organizational climate on ethics; the role of Board of Directors in making the ethical climate of an organization; the concept of ethics programme; Ethics training and communication; Features of a good ethics programme; Ethical Dilemmas, etc.

With the objective to enable students to have better understanding of the subject, the study also provides some case studies.

“Ethics and equity and the principles of justice do not change with the calendar.”

-D. H. Lawrence
INTRODUCTION
The organization’s values greatly influence the decisions that individuals make. The approach to ethical issues is based not only on what the employees learned from their own background, but also on what they learn from the Organizational culture and others in the organisation.

Organisational culture comprises of the attitudes, experiences, beliefs and values of an organization. It can be defined as the specific collection of values and norms which are shared by people and groups in an organization, and which control the way people interact with each other, within and outside the organization. An important component of corporate culture is its ethical climate. The ethical climate of an organization is a shared set of understanding about what correct behaviour is, and how ethical issues are handled. This climate sets the character for decision-making at all levels and in all circumstances. The ethical climate reflects whether the firm has an ethical conscience or not. It is an assimilation of many factors including the respective corporate policies on ethics, its top management’s leadership on ethical issues, industry culture, etc.

The ethical practices or climate of any organization is set at the top level. What the top managers do, the culture they establish and reinforce, makes a huge difference in the way their employees act in the organization, when faced by ethical dilemmas. When the ethical climate is hazy or negative, ethical dilemmas often result in unethical behaviour.

Organizations have programme on ethics as a way of minimizing the risk of ethical misconduct or wrong doing by the employees. These programmes consist of policies, processes, education and training initiatives that explain the company’s business ethics. They clarify how ethics should translate into operating procedures and workplace behaviour. The focus of ethics programme is compliance with rules and regulations.

ORGANIZATION 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.

### Role of the Board of Directors

The board of directors holds is ultimately responsibility for its firm’s success or failure, as well as for the ethical climate and practices of its company. As has been stated earlier the ethical tone of an organization is set at the top, the actions and attitudes of the board greatly influence the ethical climate of an organization. The directors on a company’s board assume legal responsibility for the firm’s resources and decisions. Board members have a fiduciary duty, i.e., a position of trust and confidence. Due to globalization and enhanced role of media and technology, the demand for accountability and transparency has increased greatly. This calls for ethical decision-making as well as an ethical decision-making framework.

An independent perspective and the independent judgment of directors can be helpful in determining a company’s approach towards ethical issues and stakeholders interests. Independent directors are in a position to challenge current practices and also contribute knowledge and experience of good practices.

A report by the Conference Board Commission on Public Trust and Private Enterprise suggested the following areas of oversight by a Board:

- Designation of a Board Committee to oversee ethical issues;
- Designation of an officer to oversee ethical practices and employees’ compliance with the code of ethics;
- Inclusion of ethics-related criteria in employees’ annual performance reviews and in the evaluation and compensation of management;
- Representation by senior management that all known ethical breaches have been reported, investigated, and resolved; and
- Disclosure of practices and processes the company has adopted to promote ethical behavior.

SCHEDULE IV of the Companies Act, 2013 prescribed Code for Independent Directors, which cast duty on Independent Directors to report concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy.

### ETHICS PROGRAMME

A company must have an effective ethics program to ensure that all employees understand organizational values and comply with the policies and codes of conduct that create its ethical climate. Two types of ethics program can be created. Both can be adopted simultaneously. These are:

- **Compliance Orientation Programme:** A compliance orientation creates order by requiring that employees comply with and commit to the required conduct. It uses legal terms, statutes, and contracts that teach employees the rules and penalties for non-compliance.

- **Values Orientation:** Values Orientation strives to develop shared values. Although penalties are attached, the focus is more on an abstract core of ideals, such as respect and responsibility. Instead of relying on coercion, the company’s values are seen as something to which people willingly aspire.
Most companies begin the process of establishing organizational ethics programs by developing codes of conduct. Codes of conduct are formal statements that describe what an organization expects of its employees. Such statements may take different forms like a code of ethics, a code of conduct, and a statement of values. A code of ethics is the most comprehensive and consists of general statements, sometimes altruistic or inspirational, which serve as principles and the basis for rules of conduct. A code of ethics generally specifies methods for reporting violations, disciplinary action for violations, and a structure of due process. A code of conduct is a written document that may contain some inspiration statements, but it usually specifies acceptable or unacceptable types of behaviour. A code of conduct is more akin to a regulatory set of rules and as such tends to elicit less debate about specific actions. One problem with the codes of conduct is that they tend to be developed without broad-based participation from stakeholders. Another final type of ethical statement is a statement of values, it serves the general public and also addresses distinct groups of stakeholders. Values statements are conceived by management and are fully developed with input from all stakeholders. A company can have a 'credo' which can be used as a tool to define the ethical practices that the company pursues, and the respect for stakeholders including customers, employees, community. Credo is a Latin word which means “a set of fundamental beliefs or a guiding principle.” For a company, a credo is like a mission statement.

**Best Practices in Ethics Programme**

- The recommendations of the ethics committee should include staff training, evaluations of compliance systems, appropriate funding and staffing of the corporate ethics office, and effective protections to employees who "blow the whistle" on perceived actions which are contrary to the spirit and/or letter of the code.

- Annual training on the code is a good practice. Many corporations establish independent "hot lines" or "help lines" where employees can seek guidance when they are faced with an ethical dilemma, or when they encounter any unethical conduct in the workplace.

- Every publicly listed corporation should consider establishing a regular review system to ensure that the codes are dynamic, and are updated in the light of new developments.

- Every member of the Board of Directors of a publicly listed corporation should be required to sign the Code of Ethics, and pledge that she/he will never support a Board motion to suspend the Code.

- All outside law firms and auditing firms that consult to publicly listed corporations should be required to sign statements noting that they understand and accept the corporation's Code of Ethics.

- Employees basically want to know two things- (a) what is expected or required of them to survive and to be successful (b) "what they did" at that point of time.

**Features of Good Ethics Programme**

The following factors indicate the success of an ethics programme:

- **Leadership** meaning that executives and supervisors care about ethics and values as much as they do about the bottom line.

- **Consistency between words and actions** refers that the top management “practices what it preaches”. This is more important than formal mechanisms, such as hotlines for people to report wrongdoing.

- **Fairness** means that the organisation operates fairly. To most of the employees, the most important ethical issue is how the organization treats them and their coworkers.
— **Openness** means that people can discuss ethics and values with openness and without any fear, and that ethics and values are integrated into business decision-making.

— **Just rewards** says that ethical behaviour should be fairly rewarded. This would have greater influence on the effectiveness of an ethics programme than the perception that unethical behaviour is penalised.

— **Value-driven** means that an ethical and compliance programme is based on certain values. This will have the most positive effect on ethics and compliance programme and will results in:
  - condemning unethical conduct;
  - stronger employee commitment;
  - a stronger belief that any bad news can be delivered fearlessly to the management.

### 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.

**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 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.

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<th>Model Code of Business Conduct &amp; Ethics</th>
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<td><strong>Preamble</strong></td>
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| 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.

<table>
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<th><strong>Applicability</strong></th>
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| 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.
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.

### Credo

Most companies skip the important part of developing the company’s credo. A good credo gives the company a reason to exist; it develops the spirit of employees motivating them at all times. It is a statement of common values that allows employees to understand the importance of the stakeholders and services provided. It is the force which makes them work together to achieve a consistent high standard.

Sam Walton, founder of Wal-Mart, established the “Three Basic Beliefs” as his company’s credo. They are:

- Respect for the Individual
- Service to our Customers
- Strive for Excellence

**Examples:**

1. **Johnson & Johnson**

The overarching philosophy that guides business in Johnson & Johnson is their Credo termed as ‘Our Credo’, a deeply held set of values that has served as the strategic and moral compass for generations of about Johnson & Johnson leaders and employees.

The Credo challenges Johnson & Johnson to put the needs and well-being of the people they serve first. It also speaks the responsibilities it has to its employees, to the communities in which the company thrives and works and the world community, and to its shareholders. Johnson and Johnson believes that its Credo is a blueprint for long-term growth and sustainability that’s as relevant today as when it was written.

2. **SAIL**

Credo of SAIL talks about stakeholder respect, and ethical practices to be followed in the company:

- We build lasting relationships with customers based on trust and mutual benefit. We uphold highest ethical standards in conduct of our business.
- We create and nurture a culture that supports flexibility, learning and is proactive to change.
- We chart a challenging career for employees with opportunities for advancement and rewards.
  
  We value the opportunity and responsibility to make a meaningful difference in people's lives.
THE TYLENOL CRISIS

It is the belief of Johnson & Johnson that it is its credo which has led to the company’s growth. The credo depicts company’s ethical and socially responsible approach of conducting business. The credo epitomizes the company’s responsibility to the people who use its products and services, to its employees, to the community and environment, and to its shareholders.

Johnson & Johnson's subsidiary, McNeil Consumer Products had an analgesic called Tylenol, which had been of the absolute leader in the market pain-killers in 1982. Seven persons had died mysteriously after taking cyanide laced capsules of Extra-Strength Tylenol. The deaths were broadly reported in the media and became the cause of a massive nationwide panic.

The investigation by the company revealed that the product was tampered with and Tylenol Extra-Strength capsules was replaced with cyanide laced capsules and resealed packages were deposited on the shelves of pharmacies and food stores. Through the investigation it was also revealed that the tampering had taken place in the Chicago region alone.

The media widely reported about the cyanide laced capsules and this sensational news caused a nationwide panic. The company had to suddenly explain to the world why its trusted and premium product was killing unsuspecting people.

JOHNSON & JOHNSON'S CRISIS COMMUNICATION STRATEGIES

Johnson & Johnson reacted in a matured manner to the adverse media reports.

The areas which the company had to address were firstly “how to protect the people?” and secondly “how to save the product?”

As a first step the company issued warnings using the media and advised the consumers across the United States not to consume any type of Tylenol product. Johnson & Johnson withdrew all forms of Tylenol capsules from the width and breadth of the United States of America.

Even though the company was convinced that there was little chance of discovering any more cyanide coated tablets, Johnson & Johnson made it known that they would not like to take any risk with the safety and health of the Tylenol-consuming public, even if it cost the company its reputation and millions of dollars. It was estimated that the recall included approximately 31 million bottles of Tylenol, with a retail value of more than $100 million.

The Impact of the Strategy

The recall of the Tylenol capsules was not an easy decision to make for the company. Many well-informed analysts were of the opinion that recalling all Tylenol-related products could adversely affect the business prospects of the company. Some company executives were really concerned about the panic that could be caused to the industry over such a widespread recalling of the company’s premium product.

There were others too who felt that the nationwide recall of Tylenol would effectively lay to rest any chance for the product to survive in future.

What Johnson & Johnson faced was an unusual situation for a large corporation of its size and reach in facing a crisis of such dimensions. It was the considered opinion of many that the company’s response to the crisis demonstrated clearly its commitment to customer safety and quality of its product. The open and transparent communication with public helped the company maintain a high level of credibility and customer trust. In the case of many other companies, the top brass would have thought of the huge financial loss the company would have to incur and also its reputation once it decided to recall its own product at a national level. But in this case, the then Chairman and CEO of Johnson & Johnson, James E. Burke, said, “It will take time, it will take money.
and it will be very difficult; but we consider it a moral imperative, as well as good business, to restore Tylenol to its preeminent position." Burke and his executives rather than thinking about the huge financial implications, followed both the letter and spirit of the company's credo.

The company put customer safety first before worrying about the profit and other financial concerns.

In the beginning the media made a very negative association with the brand name. Before the crisis, Johnson & Johnson had not actively sought press coverage, but as a company in crisis they recognised the advantage of open communication in clearly disseminating warnings to the public as well as a clear enunciation of the company's stand. The company also stopped the production and advertising of Tylenol and ordered the recall of all Tylenol capsules from the market.

Johnson & Johnson concentrated on a comeback plan. To restore the confidence and trust of the public in Tylenol, and to make the product tamper-free, Johnson & Johnson followed a series of concerted measures. First, the company brought in a new Triple Safety Seal Packaging—a glued box, a plastic seal over the neck of the bottle, and a foil seal over the mouth of the bottle. Tylenol became the first product in the industry to use the new tamper resistant packaging within 6 months after the tampering of the product was reported. The company made the announcement of the new Triple Safety Seal Packaging at a press conference at the manufacturer's headquarters. Before the crisis, Tylenol was a premium product and had a massive advertising budget and it was number one alternative to aspirin in the country.

The Success of the Comeback Trail

Not only is Tylenol still one of the top selling over-the-counter drugs in the USA, but it took very little time for the product to return to the market. Johnson & Johnson's handling of the Tylenol tampering crisis shows that when the company dealt with the issue in an open and transparent manner the stakeholders – customers, regulators, media and shareholders - all were sympathetic. If the company had not fully cooperated with the media, they would have, in turn, received much less positive media coverage. Disapproving coverage by the media could have easily destroyed Tylenol's reputation permanently, and with it Johnson & Johnson's as well.

ETHICS TRAINING AND COMMUNICATION

A major step in developing an effective ethics program would be to implement a training program and communication system to train educate and communicate employees about the firm's ethical standards.

Training programs can educate employees about the firm's policies and expectations, as well as relevant laws, regulations and general social standards. These can also make employees aware of available resources, support systems, and designated personnel who can assist them with ethical and legal advice. They empower employees to ask tough questions and make ethical decisions. Many companies are now incorporating ethics training into their employee and management development training efforts.

If ethics training is to be effective, it must start with a foundation, a code of ethics, a procedure for airing ethical concerns, line and staff involvements, and executive priorities on ethics that are communicated to employees. Managers from every department must be involved in the development of an ethics training program. Training and communication initiatives should reflect the unique characteristics of organization; its size, culture, values, management style, and employee base. It is important for the ethics program to differentiate between personal and organizational ethics.

To be successful, business ethics programs should educate employees about formal ethical frameworks and mode for analyzing business ethics issue. So that employees can base ethical decisions on their knowledge of choices rather than on emotions.
Written standards deter wrongdoing and promote:

1. Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

2. Full, fair, accurate, timely, and understandable disclosure in reports and documents that a company files with, or submits to, the Commission and in other public communications made by the [company];

3. Compliance with applicable governmental laws, rules and regulations;

4. The prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and,

5. Accountability for adherence to the code.

ETHICS COMMITTEE

Codes of conduct are an outgrowth of company missions, visions, strategies and values. Thoughtful and effective corporate codes provide guidance for making ethical business decisions that balance conflicting interests.

Codes of conduct need to be living documents that are encouraged and valued at the highest levels. Board members and senior executives have to set an example for the type of conduct they expect from others. Ethical lapses at the higher levels of management tend to be perceived as tacit permission to commit lapses at lower levels. Senior management needs to hold itself to the highest standards of conduct before it can demand similar integrity from those at lower levels.

Writing a code of conduct, supporting it at top levels and communicating it to employees is just a beginning. Companies should have a committee of independent non-executive directors who are responsible for ensuring that systems are in place in the company to assure employee compliance with the Code of Ethics.

**Functions of Ethics Committee:**

The oversight process of the Ethics Committee of an organization involves the following areas to be addressed by it:

*Review of the definitions of standards and procedures*

The Committee should review the organization’s areas of operation, the activities that require a formal set of ethical standards and procedures.

Once the review is complete and any shortcomings come to light, the ethics committee should assign the creation of revised guidelines to the appropriate personnel, including the design of a formal method for communicating standards, and procedures to employees. This method should ensure that employees understand as well as accept the ethics program.

The ethics committee can suggest behaviors to upper management that reinforce the organization's guidelines.

*Facilitate Compliance*

The ethics Committee has the responsibility for overall compliance. It is the responsible authority for ethics compliance within its area of jurisdiction. It should serve as the court of last resort concerning interpretations of the organization's standards and procedures. In case of inconsistencies, the
committee should make recommendations on improving the existing compliance mechanisms. And, there should be regular follow-ups to ensure that compliance recommendations are understood and accepted.

**Due diligence of prospective employees**

The ethics committee should define how the organization will balance the rights of individual applicants and employees against the organization's need to avoid risks that come from placing known violators in positions of discretionary responsibility. This includes the oversight of background investigations on employees and applicants who are being considered for such positions.

**Oversight of communication and training of ethics programme**

The ethics committee should define methods and mechanisms for communicating ethical standards and procedures. This includes the distribution of documents (codes of conduct, for example) to ensure that every employee understands and accepts the organization's ethical guidelines. To make certain that published standards are understood, the ethics committee should provide regular training sessions, as well.

Since communication is a two-way process, the ethics committee should solicit stakeholders input regarding how standards and procedures are defined and enforced. In this connection, it is useful to create ways of providing proof that each employee has received the appropriate documents and understands the standards and procedures described therein.

**Monitor and audit compliance**

Compliance is an ongoing necessity and the ethics committee should design controls which monitor, audit and demonstrate employees' adherence to published standards and procedures. There should also be some mechanisms to check the effectiveness and reliability of such internal controls.

To warrant that the organization's goals, objectives and plans are not in conflict with its ethical standards and procedures, the ethics committee should develop methods for regular review and assessment.

**Enforcement of disciplinary mechanism**

Disciplinary provisions should be in place to ensure consistent responses to similar violations of standards and procedures (as against applying different standards to different employees based on their position, performance, function, and the like). There should be provisions for those who ignore as well as for those who violate standards and procedures.

**Analysis and follow-up**

When violations occur, the ethics committee should have ways to identify why they occurred. It is also important that lessons learned from prior violations are systematically applied to reduce the chances of similar violations taking place in future.

**INTEGRITY PACT**

Developed by Transparency International (TI), the Integrity Pact (IP) is a tool aimed at preventing corruption in public contracting. It consists of a process that includes an agreement between a government or a government department and all bidders for a public contract. It contains rights and obligations to the effect that neither side will pay, offer, demand or accept bribes; collude with competitors to obtain the contract; or engage in such abuses while carrying out the contract. The IP
also introduces a monitoring system that provides for independent oversight and accountability.

**What is an integrity pact?**

*A written agreement between the government/government department and all bidders to refrain from bribery and collusion*

Bidders are required to disclose all commissions and similar expenses paid by them to anyone in connection with the contract. If the written agreement is violated then the pact describes the sanctions that shall apply. These may include:

- Loss or denial of contract;
- Forfeiture of the bid or performance bond and liability for damages;
- Exclusion from bidding on future contracts (debarment); and,
- Criminal or disciplinary action against employees of the government.

*A monitoring system that provides for independent oversight and increased government accountability of the public contracting process*

In most cases, monitors are members of civil society or experts appointed by (and reporting to) the TI Chapter and its civil society partners. The independent monitoring system aims to ensure that the pact is implemented and the obligations of the parties are fulfilled. The monitor performs functions such as:

- Overseeing corruption risks in the contracting process and the execution of work;
- Offering guidance on possible preventive measures;
- Responding to the concerns and/or complaints of bidders or interested external stakeholders;
- Informing the public about the contracting process’s transparency and integrity (or lack thereof).

**Why use an integrity pact?**

**Companies** can abstain from bribing safe in the knowledge that

- their competitors have provided assurances to do the same, and
- government procurement, privatisation or licensing agencies will follow transparent procedures and undertake to prevent corruption, including extortion, by their officials

**Governments** can reduce the high cost and distorting impact of corruption on public procurement, privatisation or licensing in their programmes, which will have a more hospitable investment climate and public support.

**Citizens** can more easily monitor public decision-making and their government’s activities.

The following - Goals, Roles, Expectations and Priorities should be communicated to the employees:

- People should be reminded/repeatedly communicated of the short term and long term goals of the job. They should see how their goals support the organization’s mission and vision. Employees should be made aware of the fact that how a goal is accomplished is just as important as accomplishing the goal itself. Cutting corners could hurt the corporation, its reputation and, eventually, the individual employee.
- Employees should know how their job fits into the bigger picture. This will remind them of their
importance and value. It is very important to ensure that they understand their role, and understand what kind of conduct is expected of them in the Company.

— Employees should understand exactly what is expected of them. They should know what is to be done and when. They should be aware of the fact that what standards are to be achieved and maintained. They should understand how their achievements will be evaluated; what is to be done if they encountered any hurdle or unanticipated changes; and how any conflict is to be handled.

— Employees should have clarity of the organization's operational priorities.

Whistle Blower Policy and Vigil Mechanism

Case Example: Enron, a Houston-based energy company founded by a brilliant entrepreneur, Kenneth Lay. The company was created in 1985 by a merger of two American gas pipeline companies in Nebraska and Texas. Lay assumed the role of chairperson and CEO, a position he held through most of the next 16 years, until the company's downfall in 2001. In a period of 16 years the company was transformed from a relatively small concern, involved in gas pipelines, oil and gas exploration, to the world's largest energy trading company. In 2001 Enron became a household name—and probably in most households in most countries around the world. On 2 December, 2001 Enron, one of the 10 largest companies in the US, filed for bankruptcy.

During the boom years of the late 1990s the company positioned itself as a trader of virtually any type of asset: pulp and paper, weather derivatives, commodities, credits, and so on. It also expanded into areas that it thought would benefit from rapid growth, including water (following deregulation measures), fiber optic capacity/Internet bandwidth, and so on. At the end of 1999, Enron launched its Internet based trading platform—Enron online. In February 2001, the company's stock market value was USD 4.60 billion.

In early 2001, as Lay handed the CEO role to Skilling, Enron reached an apex: the company reported revenues of US $ 100 billion and ranked seventh on the Fortune 500 list of largest global companies.

In early 2001, however, the company's problems started mounting; the expensive expansion into the broadband sector became questionable. Enron's stock prices started falling. In August 2001 the chief executive Jeffery Skilling, left the company following concerns about the company's management. Former CEO Lay returned to his old role (retaining the board chair as well).

Whistleblowers within the firm—aware of widespread financial improprieties—were attempting to convey information to the board of directors; one employee, Sherron Watkins, Enron's vice president of corporate development, was finally successful in alerting certain board members that all was not well. In November 2001, it became clear that Enron was facing serious financial problems.

Meaning and Definition

The term “whistle-blowing” originates from the practice of British policemen who blew their whistles whenever they observed commission of a crime. The term ‘whistle-blowing’ is a relatively recent entry into the vocabulary of public and corporate affairs although the phenomenon itself is not new.

The concept of a Whistleblower was in existence even in Ancient India, Kautilya had proposed—“Any informant (sūchaka) 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) whistleblowing 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 whistleblowing 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 whistleblowing.

3. Alumni: When the whistleblowing is done by the former employee of the organization it is called alumni whistle blowing.

4. Open: When the identity of the whistleblower is revealed, it is called Open Whistle Blowing.

5. Personal: Where the organizational wrongdoings are to harm one person only, disclosing such wrong doings it is called personal whistle blowing.
6. Impersonal: When the wrong doing is to harm others, it is called impersonal whistle blowing.

7. Government: When a disclosure is made about wrong doings or unethical practices adopted by the officials of the Government.

8. Corporate: When a disclosure is made about the wrongdoings in a business corporation, it is called corporate whistle blowing.

**Whistle Blowing under Sarbanes-Oxley Act, 2002 (SOX):**

Section 302 of Sarbanes Oxley Act of 2002, an Act enacted by U.S. congress to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes contains following provisions for whistle-blowers:

- Make it illegal to “discharge, demote, suspend, threaten, harass or in any manner discriminate against” whistleblowers
- Establish criminal penalties of up to 10 years for executives who retaliate against whistleblowers
- Require board audit committees to establish procedures for hearing whistleblower complaints
- Allow the secretary of labour to order a company to rehire a terminated employee with no court hearing.
- Give a whistleblower the right to a jury trial, bypassing months or years of administrative hearings

**Whistle Blowing mechanism suggested under Corporate Governance Voluntary Guidelines, 2009**

- The companies should ensure the institution of a mechanism for employees to report concerns about unethical behaviour, actual or suspected fraud, or violation of the company’s code of conduct or ethics policy.
- The companies should also provide for adequate safeguards against victimization of employees who avail of the mechanism, and also allow direct access to the Chairperson of the Audit Committee in exceptional cases.

**Vigil Mechanism under Companies Act, 2013**

1. Every listed company and the companies belonging to the following class or classes shall establish a vigil mechanism for their directors and employees to report their genuine concerns or grievances-
   (a) the Companies which accept deposits from the public;
   (b) the Companies which have borrowed money from banks and public financial institutions in excess of fifty crore rupees.

   (Section 177(9) and Rule 7(1) of Companies (Meetings of Board and its Powers) Rules, 2014)

2. The vigil mechanism under sub-section (9) shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases. [Section 177(10)]

3. The details of establishment of such mechanism shall be disclosed by the company on its website, if any, and in the Board’s report. [proviso to Section 177(10)]

4. The companies which are required to constitute an audit committee shall oversee the vigil mechanism through the committee and if any of the members of the committee have a conflict of
interest in a given case, they should recuse themselves and the others on the committee would deal
with the matter on hand. [Rule 7(2) of Companies (Meetings of Board and its Powers) Rules, 2014]

5. In case of other companies, the Board of directors shall nominate a director to play the role of audit
committee for the purpose of vigil mechanism to whom other directors and employees may report
their concerns. [Rule 7(3) of Companies (Meetings of Board and its Powers) Rules, 2014]

6. The vigil mechanism shall provide for adequate safeguards against victimisation of employees and
directors who avail of the vigil mechanism and also provide for direct access to the Chairperson of
the Audit Committee or the director nominated to play the role of Audit Committee, as the case may
be, in exceptional cases. [Rule 7(4) of Companies (Meetings of Board and its Powers) Rules, 2014]

7. In case of repeated frivolous complaints being filed by a director or an employee, the audit
committee or the director nominated to play the role of audit committee may take suitable action
against the concerned director or employee including reprimand. [Rule 7(5) of Companies
(Meetings of Board and its Powers) Rules, 2014]

**Vigil mechanism under SEBI Listing Obligations and Disclosure Requirements, 2015**

1. The listed entity shall formulate a vigil mechanism for directors and employees to report genuine
concerns.

2. The vigil mechanism shall provide for adequate safeguards against victimization of director(s) or
employee(s) or any other person who avail the mechanism and also provide for direct access to the
chairperson of the audit committee in appropriate or exceptional cases.

3. The listed entity shall disseminate the details of establishment of vigil mechanism/ Whistle Blower
policy.

4. The disclosure regarding the details of establishment of vigil mechanism, whistle blower policy, and
affirmation that no personnel has been denied access to the audit committee shall be made in the
section on the corporate governance of the annual report.

**SOCIAL AND ETHICAL ACCOUNTING**

Social and ethical accounting is a process that helps a company to address issues of accountability to
stakeholders, and to improve performance in all spheres, i.e. social, environmental and economic.
The process normally links a company’s values to the development of policies and performance targets
and to the assessment and communication of performance.

Social and ethical accounting has no standardized model. There is no standardized balance sheet or
unit of currency. The issues are defined by the company’s values and aims, by the interests and
expectations of its stakeholders, and by societal norms and regulations. With the focus on the concerns
of society, the social and ethical accounting framework implicitly concerns itself with issues, such as
economic performance, working conditions, environmental and animal protection, human rights, fair
trade and ethical trade, human resource management and community development, and hence with the
sustainability of a company’s activities.

**Principles of social and ethical accounting**

The dominant principle of social and ethical accounting is inclusivity. This principle requires that the
aspirations and needs of all stakeholder groups are taken into account at all stages of the social and
ethical accounting process.
— **Planning**: The company commits to the process of social and ethical accounting, auditing and reporting, and defines and reviews its values and social and ethical objectives and targets.

— **Accounting**: The scope of the process is defined, information is collated and analysed, and performance targets and improvement plans are developed.

— **Reporting**: A report on the company’s systems and performance is prepared.

— **Auditing**: The process of preparing the report, with the report itself, is externally audited, and the report is made accessible to stakeholders in order to obtain feedback from them.

— **Embedding**: To support each of the stages, structures and systems are developed to strengthen the process and to integrate them into the company’s activities.

— **Stakeholder engagement**: The concerns of stakeholders are addressed at each stage of the process through regular involvement.

The nature of social and ethical reporting is related to the size and nature of the organization. Even a comprehensive and clear report needs to be trusted to be valuable.

### ETHICS AUDIT

The reasons for examining the state of a company’s ethics are many and various. They include external societal pressures, risk management, stakeholder obligations, and identifying a baseline to measure future improvements. In some cases, companies are driven to it by a gross failure in ethics, which may have resulted in costly legal action or stricter government regulation. An ethical profile brings together all the factors which affect a company’s reputation, by examining the way in which it does business. The following are the some of the suggested steps in ethics audit:

1. The first step in conducting an audit is securing the commitment of the firm’s top management.
2. The second step is establishing a committee or team to oversee the audit process.
3. The third step is establishing the scope of the audit.
4. The fourth step should include a review of the firm’s mission values, goals, and policies.
5. The fifth step is identifying the tools or methods that can be employed to measure the firm’s progress and then collecting and analyzing the relevant information.
6. The sixth step is having the results of the data analysis verified by an independent party.
7. The final step in the audit process is reporting the audit findings to the board of directors and top executives and, if approved, to external stakeholders.

Social and ethical accounting, auditing and reporting are in embryonic stage. The best practices are gradually emerging and will continue to develop over the coming years. Social and ethical accounting provides a way in which companies can assess their performance and bring the perspective of stakeholders into this assessment. By bringing social and ethical accountability process into its strategy and operations, a company can measure its performance for itself and for its stakeholders as well. This will help a company to address a series of risks that may otherwise arise unseen and unchecked with any of the stakeholder.
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.

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.

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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.
CONCLUSION

Ethics is the first line of defense against corruption, while law enforcement is remedial and reactive.

Good corporate governance goes beyond rules and regulations that the Government can put in place. It is also about ethics and the values which drive companies in the conduct of their business. It is, therefore, all about the trust that is established over time between the companies and their different stakeholders. Good corporate governance practices cannot guarantee corporate success, but the absence of such governance definitely lead to questionable practices and corporate failures, which surface suddenly and massively.

LESSON ROUND-UP

- The organization's values greatly influence the decisions that individuals make.
- Organization culture comprises of the attitudes, experiences, beliefs and values of an organization.
- The board of directors holds the ultimate responsibility for their firm's success or failure, as well as for ethics of their actions.
- The ethical tone of an organization is set at the top, the actions and attitudes of the board greatly influence the ethical climate of an organization.
- An organization's structure is important to the study of business ethics. – Centralized organization and decentralized organization.
- A company must have an effective ethics program to ensure that all employees understand its values and comply with the policies and codes of conduct that create its ethical climate.
- Two types of ethics program that can be created - Compliance Orientation Programme and Values Orientation
- 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.
- 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.
- 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.
- A company can have a credo, which can be used as a tool to define the ethical practices that the company pursues and thus shows respect for stakeholders.
- Companies should have a committee of independent non-executive directors who should have the responsibility to ensure that the systems are in place to assure employee compliance with the code of ethics.
- A major step in developing an effective ethics programme would be to implement a training programme and a communication system in order to communicate and educate employees about the firm’s ethical standards.
Social and ethical accounting is a process that helps a company to address issues of accountability to stakeholders, and to improve performance in all aspects, i.e. social, environmental and economic.

The dominant principle of social and ethical accounting is inclusivity. This principle requires that the aspirations and needs of all stakeholder groups are taken into account, at all stages of the social and ethical accounting process.

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. It is now a mandatory requirement for Listed companies.

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.

### 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. Elucidate the role of leadership on ethics in an organization.
3. Describe the importance of ethics training.
4. Describe Ethical Dilemma.
5. Write a short note on Whistle Blower Policy.
Lesson 3
Conceptual Framework of Corporate Governance

LESSON OUTLINE

- Introduction
- Definitions
- Need for Corporate Governance
- Evidence of Corporate Governance from the Arthashastra
- Corporate Governance Theories
- Evolution of Corporate Governance
- Corporate Governance Developments in USA
- Corporate Governance Developments in UK
- Corporate Governance Developments in South Africa
- Corporate Governance Developments in India
- Elements of Good Corporate Governance
- 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 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.

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

-Mervyn king S.C.
INTRODUCTION

**Governance**

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

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

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

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

The heart of corporate governance is transparency, disclosure, accountability and integrity. It is to be borne in mind that mere legislation does not ensure good governance. Good governance flows from ethical business practices even when there is no legislation.

**Definitions of Corporate Governance**

There is no universal definition of corporate governance. Some good definitions are given hereunder for your better understanding:

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

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

James D. Wolfensohn (Ninth President World Bank)

**OECD**

“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.

**Cadbury Committee, U.K**

Corporate Governance is a system of structuring, operating and controlling a company with the following specific aims:
“(It is) the system by which companies are directed and controlled”.

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

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

Mervyn King (Chairman: King Report)

‘There is always a link between good governance and compliance with law. Good governance is not something that exists separately from the law and it is entirely inappropriate to unhinge governance from law.’

King Report on Governance for South Africa 2009

“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.”


“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.”

Report of Kumar Mangalam Birla Committee on Corporate Governance constituted by SEBI (1999)

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

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

Institute of Company Secretaries of India

NEED FOR CORPORATE GOVERNANCE

Corporate Governance is needed to create a corporate culture of transparency, accountability and disclosure. It refers to compliance with all the moral & ethical values, legal framework and voluntarily adopted practices.

(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: Investors consider corporate governance as important as financial performance when evaluating companies for investment. Investors who are provided with high levels of disclosure and transparency are likely to invest openly in those companies. The consulting firm McKinsey surveyed and determined that global institutional investors are prepared to pay a premium of up to 40 percent for shares in companies with superior corporate governance practices.

(c) Better Access To Global Market: Good corporate governance systems attract investment from global investors, which subsequently leads to greater efficiencies in the financial sector.

(d) Combating Corruption: Companies that are transparent, and have sound systems 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 investors relation. Good Corporate Governance practices create the environment whereby Boards cannot ignore their accountability to these stakeholders.

**EVIDENCE OF CORPORATE GOVERNANCE FROM THE ARTHASHASTRA**

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

<table>
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<tr>
<th>Kautilya’s fourfold duty of a king –</th>
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<tr>
<td>Raksha, vridhi, palana, Yogakshema.</td>
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</table>

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.

i. **Raksha** – literally means protection, in the corporate scenario it can be equated with the risk management aspect.

ii. **Vriddhi** – literally means growth, in the present day context can be equated to stakeholder value enhancement.

iii. **Palana** – literally means maintenance/compliance, in the present day context it can be equated to compliance to the law in letter and spirit.

iv. **Yogakshema** – literally means well being and in Kautlya’s Arthashastra 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 which 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.

![Diagram of Corporate Governance](image)

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:

![Stakeholders Diagram](image)

**Corporate Governance Theories**

The following theories elucidate the basis 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 managers 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 managers 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 interest 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.

**E V O L U T I O N  O F  C O R P O R A T E  G O V E R N A N C E**

**Corporate Governance Developments in USA**

<table>
<thead>
<tr>
<th>Years</th>
<th>Developments</th>
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<tbody>
<tr>
<td>1977</td>
<td>The Foreign Corrupt Practices Act Provides for specific provisions regarding establishment, maintenance and review of systems of internal control.</td>
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<tr>
<td>1985</td>
<td>Treadway commission Emphasized the need of putting in place a proper control environment, desirability of constituting independent boards and its committees and objective internal audit function. As a consequence, the Committee of Sponsoring Organisations (COSO) took birth.</td>
</tr>
<tr>
<td>1992</td>
<td>COSO issued Internal Control – Integrated Framework. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued Internal Control – Integrated Framework. It is a framework &quot;to help businesses and other entities assess and enhance their internal control systems&quot;.</td>
</tr>
<tr>
<td>2002</td>
<td>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 wilful default by managers and auditors, in particular.</td>
</tr>
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<td></td>
<td>The Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010 Vote on Executive Pay and Golden Parachutes: Gives shareholders a say on pay with the right to a non-binding (advisory) vote on executive pay and golden parachutes (acquisitions). This gives shareholders a powerful opportunity to hold accountable executives of the companies they own, and a chance to disapprove where they see the kind of misguided incentive schemes that threatened individual companies and in turn the broader economy.</td>
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**Corporate Governance Developments in UK**

Recommendations of Report of Committee on **The Financial Aspects on Corporate Governance, 1992** under the chairmanship of Sir Adrian Cadbury set up by the London Stock Exchange, the Financial Reporting Council and accounting professions to focus on the control and reporting functions of boards, and on the role of auditors.
• Role of Board of Directors

The Report introduced “The Code of Best Practice” directing the boards of directors of all listed companies registered in the UK, and also encouraging as many other companies as possible aiming at compliance with the requirements. All listed companies should make a statement about their compliance with the Code in their report and accounts as well as give reasons for any areas of non-compliance. It is divided into four sections:

1. Board of Directors:

   (a) The board should meet regularly, retain full and effective control over the company and monitor the executive management.

   (b) There should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision.

   (c) Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognized senior member, that is, there should be a lead independent director.

   (d) All directors should have access to the advice and services of the company secretary, who is responsible to the Board for ensuring that board procedures are followed and that applicable rules and regulations are complied with.

2. Non-Executive Directors:

   (a) The non-executive directors should bring an independent judgment to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct.

   (b) The majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment, apart from their fees and shareholding.

3. Executive Directors:

   There should be full and clear disclosure of directors’ total emoluments and those of the chairman and highest-paid directors, including pension contributions and stock options, in the company's annual report, including separate figures for salary and performance-related pay.

4. Financial Reporting and Controls:

   It is the duty of the board to present a balanced and understandable assessment of their company's position, in reporting of financial statements, for providing true and fair picture of financial reporting. The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary. The board should ensure that an objective and professional relationship is maintained with the auditors.

• Role of Auditors

The Report recommended for the constitution of Audit Committee with a minimum of three non-executive members majority of whom shall be independent directors.

The Report recommended that a professional and objective relationship between the board of directors and auditors should be maintained, so as to provide to all a true and fair view of company's financial
statements. Auditors' role is to design audit in such a manner so that it provide a reasonable assurance that the financial statements are free of material misstatements.

The Report recommended for rotation of audit partners to prevent the relationships between the management and the auditors becoming too comfortable.

- **Rights & Responsibilities of Shareholders**

The Report emphasises on the need for fair and accurate reporting of a company's progress to its shareholders. The Report placed importance on the role of institutional investors/ shareholders and encouraged them to make greater use of their voting rights and take positive interest in the board functioning. Both shareholders and boards of directors should consider how the effectiveness of general meetings could be increased as well as how to strengthen the accountability of boards of directors to shareholders.

<table>
<thead>
<tr>
<th>Year</th>
<th>Report</th>
<th>Details</th>
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<tr>
<td>1995</td>
<td>Greenbury Report</td>
<td>Confederation of British Industry constituted a group under the chairmanship of Sir Richard Greenbury to make recommendations on Directors’ Remuneration. Major Findings: 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’. 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.</td>
</tr>
<tr>
<td>1998</td>
<td>Hampel Report</td>
<td>The Hampel Committee was established to review and revise the earlier recommendations of the Cadbury and Greenbury Committees. An important development was in the area of accountability and audit. The Board was identified as having responsibility to maintain a sound system of internal control, thereby safeguarding shareholders’ investments. Further, the Board was to be held accountable for all aspects of risk management. Recommendations of this Report and further consultations by the London Stock Exchange became the Combined Code on Corporate Governance. – The original combined Code.</td>
</tr>
<tr>
<td>1999</td>
<td>Turnbull Report</td>
<td>The report informs directors of their obligations under the Combined Code with regard to keeping good &quot;internal controls&quot; in their companies, or having good audits and checks to ensure the quality of financial reporting and catch any fraud before it becomes a problem. Turnbull Committee published “Internal Control Guidance for Directors on Combined Code”. Revised version was issued in 2004. Further Revised “Internal Control Guidance for Directors on Combined Code” were issued in October, 2005.</td>
</tr>
<tr>
<td>2001</td>
<td>Myners: Review of</td>
<td>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</td>
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### Institutional Investment

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<th>Year</th>
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<th>Details</th>
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<tr>
<td>2008</td>
<td>Combined Code on Corporate Governance</td>
<td>The <strong>Combined Code on Corporate Governance</strong> sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders. All companies incorporated in the UK and listed on the main market of the London Stock Exchange are required under the Listing Rules to report on how they have applied the Combined Code in their annual report and accounts.</td>
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<tr>
<td>2009</td>
<td>Walker Review of Corporate Governance of UK Banking Industry</td>
<td>The principal focus of this Review has been 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 are as follows: To examine corporate governance in the UK banking industry and make recommendations, including in the following areas: the effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively; the balance of skills, experience and independence required on the boards of UK banking institutions; the effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees; the role of institutional shareholders in engaging effectively with companies and monitoring of boards; and whether the UK approach is consistent with international practice and how national and international best practice can be promulgated.</td>
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<tr>
<td>2012</td>
<td>UK Corporate Governance Code (Revised)</td>
<td>Revised version of earlier code (2010) includes that boards should confirm that the annual report and accounts taken as a whole are fair, balanced and understandable, that audit committees should report more fully on their activities and that FTSE 350 companies should put the external audit contract out to tender at least every ten years. The requirement for companies to report on their boardroom diversity policies, first announced in 2011, also came into effect. As with all existing provisions of the Code, these additions are subject to “comply or explain”. <em>FTSE - FTSE is an independent index company jointly owned by The Financial Times and the London Stock Exchange.</em></td>
</tr>
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</table>
| 2012 | The UK Stewardship Code (Revised) | 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.

The main changes to the Stewardship Code (2012) include: clarification of the respective responsibilities of asset managers and asset owners for stewardship, and for stewardship activities that they have chosen to outsource; and clearer reporting requirements, including on the policy on stock lending.

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

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

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

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<thead>
<tr>
<th>King II Report on Corporate Governance (2002)</th>
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<tbody>
<tr>
<td>In 2002, the second King Report on Corporate Governance was published. It contains a Code of Corporate Practices and Conduct. It refers to seven characteristics of good corporate governance:</td>
</tr>
<tr>
<td>1. <strong>Discipline</strong> - a commitment to behaviour that is universally recognised and accepted as correct and proper.</td>
</tr>
<tr>
<td>2. <strong>Transparency</strong> - the ease with which an outsider is able to analyse a company’s actions.</td>
</tr>
<tr>
<td>3. <strong>Independence</strong> - the mechanisms to avoid or manage conflict.</td>
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<tr>
<td>4. <strong>Accountability</strong> - the existence of mechanisms to ensure accountability.</td>
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<td>5. <strong>Responsibility</strong> - processes that allow for corrective action and acting responsibly towards all stakeholders.</td>
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<td>6. <strong>Fairness</strong> - balancing competing interests.</td>
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<td>7. <strong>Social Responsibility</strong> - being aware of and responding to social issues.</td>
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<th>King III Report on Corporate Governance (2009)</th>
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<td>King III became necessary because of the anticipated new Companies Act, 2008 and changing trends in international governance. As with King I and King II, the King Committee endeavoured to be at the forefront of governance internationally and focused on the importance of reporting annually on how a company has both positively and negatively affected the economic life of the community in which it operated during the year under review. In addition, emphasis has been placed on the requirement to report on how the company intends to enhance those positive aspects and eradicate or ameliorate any possible negative impacts on the economic life of the community in which it will operate in the year ahead.</td>
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<td>King III is divided into nine chapters:</td>
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<tr>
<td>1. Ethical leadership and corporate citizenship</td>
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<td>2. Boards and directors</td>
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<td>3. Audit committees</td>
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4. The governance of risk  
5. The governance of information technology  
6. Compliance with laws, rules, codes and standards  
7. Internal audit  
8. Governing stakeholder relationships  
9. Integrated reporting and disclosure  

King III applies to “all entities regardless of the manner and form of incorporation or establishment and whether in the public, private or non-profit sectors."

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Corporate Governance Developments in India

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


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. A brief summary of the Desirable Corporate Governance Code is reproduced hereunder:

**Recommendation I — Frequency of Board Meetings**

The full board should meet a minimum of six times a year, preferably at an interval of two months, and each meeting should have agenda items that require at least half a day’s discussion.

**Recommendation II — Board Composition**

Any listed company with a turnover of Rs.100 crores and above should have professionally competent, independent, non-executive directors, who should constitute:

- atleast 30 per cent of the board if the Chairman of the company is a non-executive director, or
- atleast 50 per cent of the board if the Chairman and Managing Director is the same person.

**Recommendation III — Number of Directorships**

No single person should hold directorships in more than 10 listed companies. This ceiling excludes directorships in subsidiaries (where the group has over 50 per cent equity stake) or associate companies (where the group has over 25 per cent but no more than 50 per cent equity stake).
Recommendation IV — Role, Responsibilities, Qualifications of Non-Executive Directors

For non-executive directors to play a material role in corporate decision making and maximising long term shareholder value, they need to:

- become active participants in boards, not passive advisors;
- have clearly defined responsibilities within the board such as the Audit Committee; and
- know how to read a balance sheet, profit and loss account, cash flow statements and financial ratios and have some knowledge of various company laws. This, of course, excludes those who are invited to join boards as experts in other fields such as science and technology.

Recommendation V — Non-Executive Directors

To secure better effort from non-executive directors companies should:

- Pay a commission over and above the sitting fees for the use of the professional inputs. The present commission of 1% of net profits (if the company has a managing director), or 3% (if there is no managing director) is sufficient.
- Consider offering stock options, so as to relate rewards to performance. Commissions are rewards on current profits. Stock options are rewards contingent upon future appreciation of corporate value. An appropriate mix of the two can align a non-executive director towards keeping an eye on short-term profits as well as longer term shareholder value.

Recommendation VI — Disclosure of attendance record for re-appointment

While re-appointing members of the board, companies should give the attendance record of the concerned directors. If a director has not been present (absent with or without leave) for 50 per cent or more meetings, then this should be explicitly stated in the resolution that is put to vote.

Recommendation VII — Key information to the Board

Key information that must be reported to, and placed before, the board must contain:

- Annual operating plans and budgets, together with up-dated long term plans.
- Capital budgets, manpower and overhead budgets.
- Quarterly results for the company as a whole and its operating divisions or business segments.
- Internal audit reports, including cases of theft and dishonesty of a material nature.
- Show cause, demand and prosecution notices received from revenue authorities which are considered to be materially important (Material nature if any exposure that exceeds 1 per cent of the company’s net worth).
- Default in payment of interest or non-payment of the principal on any public deposit and/or to any secured creditor or financial institution.
- Fatal or serious accidents, dangerous occurrences, and any effluent or pollution problems.
- Defaults such as non-payment of inter-corporate deposits by or to the company, or materially substantial non-payment for goods sold by the company.
- Any issue which involves possible public or product liability claims of a substantial nature, including any judgment or order which may have either passed strictures on the conduct of the company, or
taken an adverse view regarding another enterprise that can have negative implications for the company.

- Details of any joint venture or collaboration agreement.
- Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.
- Recruitment and remuneration of senior officers just below the board level, including appointment or removal of the Chief Financial Officer and the Company Secretary.
- Labour problems and their proposed solutions.
- Quarterly details of foreign exchange exposure and the steps taken by management to limit the risks of adverse exchange rate movement, if material.

**Recommendation VIII — Audit Committee**

- Listed companies with either a turnover of over Rs.100 crores or a paid-up capital of Rs. 20 crores should set up Audit Committees within two years.
- Composition: at least three members, all drawn from a company’s non-executive directors, who should have adequate knowledge of finance, accounts and basic elements of company law.
- To be effective, the Audit Committees should have clearly defined Terms of Reference and it’s members must be willing to spend more time on the company’s work vis-à-vis other non-executive directors.
- Audit Committees should assist the board in fulfilling its functions relating to corporate accounting and reporting practices, financial and accounting controls, and financial statements and proposals that accompany the public issue of any security - and thus provide effective supervision of the financial reporting process.
- Audit Committees should periodically interact with the statutory auditors and the internal auditors to ascertain the quality and veracity of the company’s accounts as well as the capability of the auditors themselves.
- For Audit Committees to discharge their fiduciary responsibilities with due diligence, it must be incumbent upon management to ensure that members of the committee have full access to financial data of the company, its subsidiary and associated companies, including data on contingent liabilities, debt exposure, current liabilities, loans and investments.
- By the fiscal year 1998-99, listed companies satisfying criterion (1) should have in place a strong internal audit department, or an external auditor to do internal audits.

**Recommendation IX — Disclosure on shareholders information**

Under “Additional Shareholder’s Information”, listed companies should give data on:

- High and low monthly averages of share prices in a major Stock Exchange where the company is listed for the reporting year.
- Statement on value added, which is total income minus the cost of all inputs and administrative expenses.
- Greater detail on business segments, up to 10% of turnover, giving share in sales revenue, review of operations, analysis of markets and future prospects.
**Recommendation X — Consolidated Accounts**

Consolidation of Group Accounts should be optional and subject to:

- The FIs allowing companies to leverage on the basis of the group’s assets, and
- The Income-tax Department using the group concept in assessing corporate income-tax.
- If a company chooses to voluntarily consolidate, it should not be necessary to annex the accounts of its subsidiary companies under Section 212 of the Companies Act.
- However, if a company consolidates, then the definition of “group” should include the parent company and its subsidiaries (where the reporting company owns over 50% of voting stake).

**Recommendation XI — Compliance Certificate**

Major Indian stock exchanges should gradually insist upon a compliance certificate, signed by the CEO and the CFO, which clearly states that:

- The management is responsible for the preparation, integrity and fair presentation of the financial statements and other information in the Annual Report, and which also suggest that the company will continue in business in the course of the following year.
- The accounting policies and principles conform to standard practice, and where they do not, full disclosure has been made of any material departures.
- The board has overseen the company’s system of internal accounting and administrative controls systems either through its Audit Committee (for companies with a turnover of Rs.100 crores or paid-up capital of Rs. 20 crores) or directly.

**Recommendation XII — Disclosure relating to GDRs**

For all companies with paid-up capital of Rs. 20 crores or more, the quality and quantity of disclosure that accompanies a GDR issue should be the norm for any domestic issue.

**Recommendation XIII — Funding**

The Government must allow far greater funding to the corporate sector against the security of shares and other paper.

**Recommendation XIV — Nominee Director**

It would be desirable for FIs as pure creditors to re-write their covenants to eliminate having nominee directors except:

- in the event of serious and systematic debt default; and
- in case of the debtor company not providing six-monthly or quarterly operational data to the concerned FI(s).

**Recommendation XV — Disclosure of Ratings**

- If any company goes to more than one credit rating agency, then it must divulge in the prospectus and issue document the rating of all the agencies that did such an exercise.
- It is not enough to state the ratings. These must be given in a tabular format that shows where the company stands relative to higher and lower ranking. It makes considerable difference to an investor
to know whether the rating agency or agencies placed the company in the top slots or in the middle or in the bottom.

- It is essential that we look at the quantity and quality of disclosures that accompany the issue of company bonds, debentures, and fixed deposits in the USA and Britain - if only to learn what more can be done to inspire confidence and create an environment of transparency.

- Companies which are making foreign debt issues cannot have two sets of disclosure norms: an exhaustive one for the foreigners, and a relatively minuscule one for Indian investors.

**Recommendation XVI — Default on fixed deposits by company**

Companies that default on fixed deposits should not be permitted to:

- accept further deposits and make inter-corporate loans or investments until the default is made good; and
- declare dividends until the default is made good.


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. These recommendations, aimed at improving the standards of Corporate Governance, are divided into mandatory and non-mandatory recommendations. The said recommendations have been made applicable to all listed companies with the paid-up capital of Rs. 3 crores and above or net worth of Rs. 25 crores or more at any time in the history of the company. The ultimate responsibility for putting the recommendations into practice lies directly with the Board of Directors and the management of the company.

A summary of the Report is reproduced hereunder:

- The Board should have an optimum combination of Executive and Non Executive Directors with not less than 50 per cent of the Board consisting of non-executive directors.

In the case of Non-executive Chairman, at least one-third of the Board should consist of independent directors and in the case of an executive Chairman, at least half of the Board should consist of independent directors. The committee agreed on the following definition of independence:

> “Independent directors are directors who apart from receiving director’s remuneration do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the board may affect their independence of judgment.”

- Board meetings should be held at least four times in a year, with a maximum time gap of four months between any two meetings. A director should 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.
• Financial Institutions should appoint nominee directors on a selective basis and nominee director should have the same responsibility, be subject to the same discipline and be accountable to the shareholders in the same manner as any other director of the company.

• Non-executive Chairman should be entitled to maintain Chairman’s office at the expense of the company and also allowed reimbursement of expenses incurred in performance of his duties.

• Audit Committee - that a qualified and independent audit committee should be set up by the board of a company

→ Composition

• the audit committee should have minimum three members, all being non-executive directors, with the majority being independent, and with at least one director having financial and accounting knowledge;

• the chairman of the committee should be an independent director;

• the chairman should be present at Annual General Meeting to answer shareholder queries;

• the audit committee should 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 but on occasions it may also meet without the presence of any executives of the company. Finance director and head of internal audit and when required, a representative of the external auditor should be present as invitees for the meetings of the audit committee;

• the Company Secretary should act as the secretary to the committee.

→ Frequency of Meeting

• The audit committee should meet at least thrice a year. One meeting must be held before finalisation of annual accounts and one necessarily every six months.

→ Quorum

• The quorum should be either two members or one-third of the members of the audit committee, whichever is higher and there should be a minimum of two independent directors.

→ Powers of Audit Committee

• To investigate any activity within its terms of reference.

• To seek information from any employee.

• To obtain outside legal or other professional advice.

• To secure attendance of outsiders with relevant expertise, if it considers necessary.

→ Functions of the Audit Committee

• 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 the appointment and removal of external auditor, fixation of audit fee and also approval for payment for any other services.

• Reviewing with management the annual financial statements before submission to the board, focusing primarily on:

  ▪ Any changes in accounting policies and practices.

  ▪ Major accounting entries based on exercise of judgment by management.
Qualifications in draft audit report.

Significant adjustments arising out of audit.

The going concern assumption.

Compliance with accounting standards.

Compliance with stock exchange and legal requirements concerning financial statements.

Any related party transactions i.e. transactions of the company of material nature, with promoters or the management, their subsidiaries or relatives etc. that may have potential conflict with the interests of company at large.

Reviewing with the management, external and internal auditors, the adequacy of internal control systems.

Reviewing the adequacy of internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure, coverage and frequency of internal audit.

Discussion with internal auditors of any significant findings and follow-up thereon.

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.

Discussion with external auditors before the audit commences, of the nature and scope of audit. Also post-audit discussion to ascertain any area of concern.

Reviewing the company's financial and risk management policies.

Looking into the reasons for substantial defaults in the payments to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors.

Remuneration Committee

Remuneration Committee should comprise of at least three directors, all of whom should be non-executive directors, the chairman of committee being an independent director. All the members of the remuneration committee should be present at the meeting. These recommendations are non mandatory.

The board of directors should decide the remuneration of non-executive directors. The Corporate Governance section of the Annual Report should make disclosures about remuneration paid to Directors in all forms including salary, benefits, bonuses, stock options, pension and other fixed as well as performance linked incentives.

- **Shareholders/Investors' Grievance Committee of Directors** – The Board should set up a Committee to specifically look into share holder issues including share transfers and redressal of shareholders’ complaints.

- **General Body Meetings** - Details of last three AGMs should be furnished

- **Disclosures** - Details of non-compliance by the company including penalties and strictures imposed by the Stock Exchanges, SEBI or any statutory authority on any matter related to capital markets during the last three years must be disclosed to the shareholders.

- **Means of communication** - Half-yearly report to be sent to each household of shareholders, details of the mode of dissemination of quarterly results and presentations made to institutional investors to be disclosed and statement of Management Discussion and Analysis to be included in the report.
• **General shareholder information** - Various specified matters of interest to be included in the Annual Report.

• **Auditor's Certificate on Corporate Governance** - There should be an Auditor's certificate on corporate governance in the Annual Report as an annexure to the Director's Report.

• Companies should consolidated accounts in respect of all subsidiaries in which they hold 51 per cent or more of the capital.

• Information like quarterly results, presentation made by companies to analysts may be put on company’s web-site or may be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own web-site.

• Shareholders to use the forum of General Body Meetings for ensuring that the company is being properly stewarded for maximising the interests of the shareholders.

• A board committee under the chairmanship of a non-executive director should be formed to specifically look into the redressing of shareholder complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc.

• Half-yearly declaration of financial performance including summary of the significant events in last six-months, should be sent to each household of shareholders.

The institutional shareholders should:

- Take active interest in the composition of the Board of Directors
- Be vigilant
- Maintain regular and systematic contact at senior level for exchange of views on management, strategy, performance and the quality of management.
- Ensure that voting intentions are translated into practice.
- Evaluate the corporate governance performance of the company.

### 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.

A Summary of Task Force Report given below:

- Higher delineation of independence criteria and minimization of interest conflict potential.
- Directorial commitment and accountability through fewer and more focused board and committee membership.
- Meaningful and transparent accounting and reporting, improved annual report along with more detailed filing with regulatory authorities, and greater facilitation for informed participation using the advances in converging information and communications technologies.
- Setting up of an independent, Autonomous Centre for Corporate Excellence to accord accreditation and promote policy research and studies, training and education, etc., in the field of corporate governance.
excellence through improved corporate governance.

- Introducing formal recognition of Corporate Social Responsibility
- Clear distinction between two basic components of governance in terms of policy making and oversight responsibilities of the board of directors, and the executive and implementation responsibilities of corporate management comprising of the managing director and his or her team of executives including functional directors.
- Apply the highest and toughest standards of corporate governance to Listed companies.
- PSUs be relieved from multiple surveillance agencies and simultaneously a commission be appointed to draft a suitable code of public behaviour.

NARESH CHANDRA COMMITTEE (2002)

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.

Highlights of Naresh Chandra Committee Report:

Recommendation 2.1: Disqualifications for audit assignments

1. In line with international best practices, the Committee recommends an abbreviated list of disqualifications for auditing assignments, which includes:

- **Prohibition of any direct financial interest in the audit client** by the audit firm, its partners or members of the engagement team as well as their ‘direct relatives’. This prohibition would also apply if any ‘relative’ of the partners of the audit firm or member of the engagement team has an interest of more than 2 per cent of the share of profit or equity capital of the audit client.

- **Prohibition of receiving any loans and/or guarantees** from or on behalf of the audit client by the audit firm, its partners or any member of the engagement team and their ‘direct relatives’.

- **Prohibition of any business relationship** with the audit client by the auditing firm, its partners or any member of the engagement team and their ‘direct relatives’.

- **Prohibition of personal relationships**, which would exclude any partner of the audit firm or member of the engagement team being a ‘relative’ of any of key officers of the client company, i.e. any whole-time director, CEO, CFO, Company Secretary, senior manager belonging to the top two managerial levels of the company, and the officer who is in default (as defined by section 5 of the Companies Act). In case of any doubt, it would be the task of the Audit Committee of the concerned company to determine whether the individual concerned is a key officer.

- **Prohibition of service or cooling off period**, under which any partner or member of the engagement team of an audit firm who wants to join an audit client, or any key officer of the client company wanting to join the audit firm, would only be allowed to do so after two years from the time they were involved in the preparation of accounts and audit of that client.

- **Prohibition of undue dependence on an audit client.** So that no audit firm is unduly dependent on an audit client, the fees received from any one client and its subsidiaries and affiliates, all together, should not exceed 25 per cent of the total revenues of the audit firm. However, to help newer and
smaller audit firms, this requirement will not be applicable to audit firms for the first five years from
the date of commencement of their activities, and for those whose total revenues are less than Rs.15
lakhs per year.

**Note:** A ‘direct relative’ is defined as the individual concerned, his or her spouse, dependent parents,
children or dependent siblings. For the present, the term ‘relative’ is as defined under Schedule IA of the
Companies Act. However, the Committee believes that the Schedule IA definition is too wide, and needs to
be rationalised for effective compliance.

**Recommendation 2.2: List of prohibited non-audit services**

The Committee recommends that the following services should not be provided by an audit firm to any
audit client:

- Accounting and bookkeeping services, related to the accounting records or financial statements of
  the audit client.
- Internal audit services.
- Financial information systems design and implementation, including services related to IT systems
  for preparing financial or management accounts and information flows of a company.
- Actuarial services.
- Broker, dealer, investment adviser or investment banking services.
- Outsourced financial services.
- Management functions, including the provision of temporary staff to audit clients.
- Any form of staff recruitment, and particularly hiring of senior management staff for the audit client.
- Valuation services and fairness opinion.

Further in case the firm undertakes any service other than audit, or the prohibited services listed above,
it should be done only with the approval of the audit committee.

**Recommendation 2.4: Compulsory Audit Partner Rotation**

- There is no need to legislate in favour of compulsory rotation of audit firms.
- However, the partners and at least 50 per cent of the engagement team (excluding article clerks and
  trainees) responsible for the audit of either a listed company, or companies whose paid up capital
  and free reserves exceeds Rs.10 crore, or companies whose turnover exceeds Rs.50 crore, should
  be rotated every five years. Persons who are compulsorily rotated could, if need be, allowed to return
  after a break of three years.

**Recommendation 2.5: Auditor’s disclosure of contingent liabilities**

It is important for investors and shareholders to get a clear idea of a company’s contingent liabilities
because these may be significant risk factors that could adversely affect the corporation’s future health.
The Committee recommends that management should provide a clear description in plain English of
each material liability and its risks, which should be followed by the auditor’s clearly worded comments
on the management’s view. This section should be highlighted in the significant accounting

**Recommendation 2.6: Auditor’s disclosure of qualifications and consequent action**

- Qualifications to accounts, if any, must form a distinct, and adequately highlighted, section of the
auditor’s report to the shareholders.

- These must be listed in full in plain English — what they are (including quantification thereof), why these were arrived at, including qualification thereof, etc.
- In case of a qualified auditor’s report, the audit firm may read out the qualifications, with explanations, to shareholders in the company’s annual general meeting.
- It should also be mandatory for the audit firm to separately send a copy of the qualified report to the ROC, the SEBI and the principal stock exchange (for listed companies), about the qualifications, with a copy of this letter being sent to the management of the company. This may require suitable amendments to the Companies Act, and corresponding changes in The Chartered Accountants Act.

**Recommendation 2.7: Management’s certification in the event of auditor’s replacement**

- Section 225 of the Companies Act needs to be amended to require a special resolution of shareholders, in case an auditor, while being eligible to re-appointment, is sought to be replaced.
- The explanatory statement accompanying such a special resolution must disclose the management’s reasons for such a replacement, on which the outgoing auditor shall have the right to comment. The Audit Committee will have to verify that this explanatory statement is ‘true and fair’.

**Recommendation 2.8: Auditor’s annual certification of independence**

- Before agreeing to be appointed (along with 224(1)(b)), the audit firm must submit a certificate of independence to the Audit Committee or to the board of directors of the client company certifying that the firm, together with its consulting and specialised services affiliates, subsidiaries and associated companies:
  1. are independent and have arm’s length relationship with the client company;
  2. have not engaged in any non-audit services listed and prohibited in Recommendation 2.2 above; and
  3. are not disqualified from audit assignments by virtue of breaching any of the limits, restrictions and prohibitions listed in Recommendations 2.1

*In the event of any inadvertent violations relating to Recommendations 2.1, 2.2 the audit firm will immediately bring these to the notice of the Audit Committee or the board of directors of the client company, which is expected to take prompt action to address the cause so as to restore independence at the earliest, and minimise any potential risk that might have been caused.*

**Recommendation 2.9: Appointment of auditors**

The Audit Committee of the board of directors shall be the first point of reference regarding the appointment of auditors. To discharge this fiduciary responsibility, the Audit Committee shall:

- discuss the annual work programme with the auditor;
- review the independence of the audit firm in line with Recommendations 2.1, 2.2 above; and
- recommend to the board, with reasons, either the appointment/re-appointment or removal of the external auditor, along with the annual audit remuneration.

*Exceptions to this rule may cover government companies (which follow section 619 of the Companies Act) and scheduled commercial banks (where the RBI has a role to play)*

**Recommendation 2.10: CEO and CFO certification of annual audited accounts**
Lesson 3  ■  Conceptual framework of Corporate Governance  67

For all listed companies as well as public limited companies whose paid-up capital and free reserves exceed Rs.10 crore, or turnover exceeds Rs.50 crore, there should be a certification by the CEO (either the Executive Chairman or the Managing Director) and the CFO (whole-time Finance Director or otherwise) which should state that, to the best of their knowledge and belief:

- They, the signing officers, have reviewed the balance sheet and profit and loss account and all its schedules and notes on accounts, as well as the cash flow statements and the Directors’ Report.
- These statements do not contain any material untrue statement or omit any material fact nor do they contain statements that might be misleading.
- These statements together represent a true and fair picture of the financial and operational state of the company, and are in compliance with the existing accounting standards and/or applicable laws/regulations.
- They, the signing officers, are responsible for establishing and maintaining internal controls which have been designed to ensure that all material information is periodically made known to them; and have evaluated the effectiveness of internal control systems of the company.
- They, the signing officers, have disclosed to the auditors as well as the Audit Committee deficiencies in the design or operation of internal controls, if any, and what they have done or propose to do to rectify these deficiencies.
- They, the signing officers, have also disclosed to the auditors as well as the Audit Committee instances of significant fraud, if any, that involves management or employees having a significant role in the company’s internal control systems.
- They, the signing officers, have indicated to the auditors, the Audit Committee and in the notes on accounts, whether or not there were significant changes in internal control and/or of accounting policies during the year under review.
- In the event of any materially significant misstatements or omissions, the signing officers will return to the company that part of any bonus or incentive- or equity-based compensation which was inflated on account of such errors, as decided by the Audit Committee.

**Recommendation 3.1: Setting up of independent Quality Review Board**

- There should be established, with appropriate legislative support, three independent Quality Review Boards (QRB), one each for the ICAI, the ICSI and ICWAI, to periodically examine and review the quality of audit, secretarial and cost accounting firms, and pass judgement and comments on the quality and sufficiency of systems, infrastructure and practices.

**Recommendation 4.1: Defining an independent director**

- An independent director of a company is a non-executive director who:
  1. Apart from receiving director’s remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;
  2. Is not related to promoters or management at the board level, or one level below the board (spouse and dependent, parents, children or siblings);
  3. Has not been an executive of the company in the last three years;
4. Is not a partner or an executive of the statutory auditing firm, the internal audit firm that are associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.

5. Is not a significant supplier, vendor or customer of the company;

6. Is not a substantial shareholder of the company, i.e. owning 2 per cent or more of the block of voting shares;

7. Has not been a director, independent or otherwise, of the company for more than three terms of three years each (not exceeding nine years in any case);

- An employee, executive director or nominee of any bank, financial institution, corporations or trustees of debenture and bond holders, who is normally called a "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.

- Moreover, if an executive in, say, Company X becomes an non-executive director in another Company Y, while another executive of Company Y becomes a non-executive director in Company X, then neither will be treated as an independent director.

- The Committee recommends that the above criteria be made applicable for all listed companies, as well as unlisted public limited companies with a paid-up share capital and free reserves of Rs.10 crore and above or turnover of Rs.50 crore and above with effect from the financial year beginning 2003.

**Recommendation 4.2: Percentage of independent directors**

Not less than 50 per cent of the board of directors of any listed company, as well as unlisted public limited companies with a paid-up share capital and free reserves of ₹10 crore and above, or turnover of ₹50 crore and above, should consist of independent directors — independence being defined in Recommendation 4.1 above.

However, this will not apply to: (1) unlisted public companies, which have no more than 50 shareholders and which are without debt of any kind from the public, banks, or financial institutions, as long as they do not change their character, (2) unlisted subsidiaries of listed companies.

Nominee directors will be excluded both from the numerator and the denominator.

**Recommendation 4.3: Minimum board size of listed companies**

The minimum board size of all listed companies, as well as unlisted public limited companies with a paid-up share capital and free reserves of ₹10 crore and above, or turnover of ₹50 crore and above should be seven — of which at least four should be independent directors.

However, this will not apply to: (1) unlisted public companies, which have no more than 50 shareholders and which are without debt of any kind from the public, banks, or financial institutions, as long as they do not change their character, (2) unlisted subsidiaries of listed companies.

**Recommendation 4.4: Disclosure on duration of board meetings/Committee meetings**

The minutes of board meetings and Audit Committee meetings of all listed companies, as well as unlisted public limited companies with a paid-up share capital and free reserves of ₹10 crore and above or turnover of
₹50 crore must disclose the timing and duration of each such meeting, in addition to the date and members in attendance.

**Recommendation 4.5: Tele-conferencing and video conferencing**

If a director cannot be physically present but wants to participate in the proceedings of the board and its committees, then a minuted and signed proceedings of a tele-conference or video conference should constitute proof of his or her participation. Accordingly, this should be treated as presence in the meeting(s). However, minutes of all such meetings should be signed and confirmed by the director/s who has/have attended the meeting through video conferencing.

**Recommendation 4.6: Additional disclosure to directors**

In addition to the disclosures specified in Clause 49 under ‘Information to be placed before the board of directors’, all listed companies, as well as unlisted public limited companies with a paid-up share capital and free reserves of ₹10 crore and above, or turnover of ₹50 crore and above, should transmit all press releases and presentation to analysts to all board members. This will further help in keeping independent directors informed of how the company is projecting itself to the general public as well as a body of informed investors.

**Recommendation 4.7: Independent directors on Audit Committees of listed companies**

Audit Committees of all listed companies, as well as unlisted public limited companies with a paid-up share capital and free reserves of ₹10 crore and above, or turnover of ₹50 crore and above, should consist exclusively of independent directors, as defined in Recommendation 4.1.

However, this will not apply to: (1) unlisted public companies, which have no more than 50 shareholders and which are without debt of any kind from the public, banks, or financial institutions, as long as they do not change their character, (2) unlisted subsidiaries of listed companies.

**Recommendation 4.9: Remuneration of non-executive directors**

- The statutory limit on sitting fees should be reviewed, although ideally it should be a matter to be resolved between the management and the shareholders.
- In addition, loss-making companies should be permitted by the DCA (Now MCA) to pay special fees to any independent director, subject to reasonable caps, in order to attract the best restructuring and strategic talent to the boards of such companies.
- The present provisions relating to stock options, and to the 1 per cent commission on net profits, is adequate and does not, at present, need any revision. However, the vesting schedule of stock options should be staggered over at least three years, so as to align the independent and executive directors, as well as managers two levels below the Board, with the long-term profitability and value of the company.

**Recommendation 4.10: Exempting non-executive directors from certain liabilities**

Time has come to insert provisions in the definitions chapter of certain Acts to specifically exempt non-executive and independent directors from such criminal and civil liabilities. An illustrative list of these Acts include the Companies Act, Negotiable Instruments Act, Provident Fund Act, ESI Act, Factories Act, Industrial Disputes Act and the Electricity Supply Act.

**Recommendation 4.11: Training of independent directors**

- All independent directors should be required to attend at least one such training course before
assuming responsibilities as an independent director, or, considering that enough programmes might not be available in the initial years, within one year of becoming an independent director. An untrained independent director should be disqualified under section 274(1)(g) of the Companies Act, 1956 after being given reasonable notice.

Other recommendations

- SEBI may refrain from exercising powers of subordinate legislation in areas where specific legislation exists as in the Companies Act, 1956.
- The Government should increase the strength of DCA’s (now MCA) offices, and substantially increase the quality and quantity of its physical infrastructure, including computerisation.
- A Corporate Serious Fraud Office (CSFO) should be set up in the Department of Company Affairs with specialists inducted on the basis of transfer/deputation and on special term contracts.
- Penalties be rationalized and related to the sums involved in the offence. Fees, especially late fees, can be related to the size of the company in terms of its paid-up capital and free reserves, or turnover, or both.
- DCA (Now MCA) should consider reducing workload at offices of ROCs by providing for a system of ‘pre-certification’ by company secretaries; the system should provide for monetary and other penalties on company secretaries who certify incorrectly, even through error or oversight.


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. Following are the highlights of recommendations:

- **Audit committees** of publicly listed companies should be required to review the following information mandatorily:
  - Financial statements and draft audit report, including quarterly/half yearly financial information;
  - Management discussion and analysis of financial condition and results of operations;
  - Reports relating to compliance with laws and to risk management;
  - Management letters/letters of internal control weaknesses issued by statutory/internal auditors; and
  - Records of related party transactions.
- All audit committee members should be “financially literate” and at least one member should have accounting or related financial management expertise.

**Explanation 1:** The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

**Explanation 2:** A member will 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.

- In case a company has followed a treatment different from that prescribed in an accounting standard, management should justify why they believe such alternative treatment is more representative of the underlying business transaction. Management should also clearly explain the alternative accounting treatment in the footnotes to the financial statements.

- Companies should be encouraged to move towards a regime of unqualified financial statements. This recommendation should be reviewed at an appropriate juncture to determine whether the financial reporting climate is conducive towards a system of filing only unqualified financial statements.

- A statement of all transactions with *related parties* including their bases should be placed before the independent audit committee for formal approval/ratification. If any transaction is not on an arm’s length basis, management should provide an explanation to the audit committee justifying the same.

- Procedures should be in place. Companies should be encouraged to train their Board members in the business model of the company as well as the risk profile of the business parameters of the company, their responsibilities as directors, and the best ways to discharge them.

- To inform Board members about the *risk assessment and minimization procedures*. These procedures should be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

- Management should place a report before the entire Board of Directors every quarter documenting the business risks faced by the company, measures to address and minimize such risks, and any limitations to the risk taking capacity of the corporation. This document should be formally approved by the Board.

- Companies raising money through an Initial Public Offering (“IPO”) should disclose to the Audit Committee, the uses/applications of funds by major category (capital expenditure, sales and marketing, working capital, etc.), on a quarterly basis. On an annual basis, the company shall prepare a statement of funds utilised for purposes other than those stated in the offer document/prospectus. This statement should be certified by the Independent auditors of the company. The audit committee should make appropriate recommendations to the Board to take up steps in this matter.

- It should be obligatory for the Board of a company to lay down the code of conduct for all Board members and senior management of a company. This code of conduct shall be posted on the website of the company.

- There shall be no nominee directors.

  Where an institution wishes to appoint a director on the Board, such appointment should be made by the shareholders.

  An institutional director, so appointed, shall have the same responsibilities and shall be subject to the same liabilities as any other director.

  Nominee of the Government on public sector companies shall be similarly elected and shall be subject to the same responsibilities and liabilities as other directors.

- All compensation paid to non-executive directors may be fixed by the Board of Directors and should be approved by shareholders in general meeting. Limits should be set for the maximum number of stock options that can be granted to non-executive directors in any financial year and in aggregate. The stock options granted to the non-executive directors shall vest after a period of at least one year.
from the date such non-executive directors have retired from the Board of the Company.

- Companies should publish their compensation philosophy and statement of entitled compensation in respect of non-executive directors in their annual report or put up on the company’s website and reference drawn thereto in the annual report.

- The term “independent director” is defined as a non-executive director of the company who:
  → apart from receiving director remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;
  → is not related to promoters or management at the board level or at one level below the board;
  → has not been an executive of the company in the immediately preceding three financial years;
  → is not a partner or an executive of the statutory audit firm or the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.
  → is not a supplier, service provider or customer of the company. This should include lessor-lessee type relationships also; and
  → is not a substantial shareholder of the company, i.e. owning two per cent or more of the block of voting shares.

- The considerations as regards remuneration paid to an independent director shall be the same as those applied to a non-executive director.

- Personnel who observe an unethical or improper practice (not necessarily a violation of law) should be able to approach the audit committee without necessarily informing their supervisors.

  Companies shall take measures to ensure that this right of access is communicated to all employees through means of internal circulars, etc. The employment and other personnel policies of the company shall contain provisions protecting “whistle blowers” from unfair termination and other unfair prejudicial employment practices.

- Companies shall annually affirm that they have not denied any personnel access to the audit committee of the company (in respect of matters involving alleged misconduct) and that they have provided protection to “whistle blowers” from unfair termination and other unfair or prejudicial employment practices.

  The appointment, removal and terms of remuneration of the chief internal auditor must be subject to review by the Audit Committee.

  Such affirmation shall form a part of the Board report on Corporate Governance that is required to be prepared and submitted together with the annual report.

- The provisions relating to the composition of the Board of Directors of the holding company should be made applicable to the composition of the Board of Directors of subsidiary companies.

  At least one independent director on the Board of Directors of the parent company shall be a director on the Board of Directors of the subsidiary company.

  The Audit Committee of the parent company shall also review the financial statements, in particular the investments made by the subsidiary company.

  The minutes of the Board meetings of the subsidiary company shall be placed for review at the
Board meeting of the parent company.

The Board report of the parent company should state that they have reviewed the affairs of the subsidiary company also.

- The **performance evaluation of non-executive directors** should be by a peer group comprising the entire Board of Directors, excluding the director being evaluated; and Peer group evaluation should be the mechanism to determine whether to extend/continue the terms of appointment of non-executive directors.

- SEBI should make rules for the following:
  - Disclosure in the report issued by a security analyst whether the company that is being written about is a client of the analyst’s employer or an associate of the analyst’s employer, and the nature of services rendered to such company, if any; and
  - Disclosure in the report issued by a security analyst whether the analyst or the analyst’s employer or an associate of the analyst’s employer hold or held (in the 12 months immediately preceding the date of the report) or intend to hold any debt or equity instrument in the issuer company that is the subject matter of the report of the analyst.

**DR. J J IRANI EXPERT COMMITTEE ON COMPANY LAW (2005)**

In 2004, 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 Extracts of the Executive summary relating to Management and Board Governance is reproduced here in below:

- **Board Composition**: Law should provide for only the minimum number of directors necessary for various classes of companies. There need not be any limit to maximum number of directors. Other than procedures for appointments, no age limit for directors need be specified in the Act.

- **Appointment and resignation of director**: Every company to have at least one director resident in India. Requirement of obtaining approval of Central Govt. under Companies Act for appointment of non-resident managerial persons should be done away with. Duty to inform the Registrar of particulars regarding appointment/resignation/death etc. of directors should be that of the company.

- **Independent Directors**: Presence of independent director on the boards of companies will lead to greater transparency in company's dealings. Law should recognize the principle of independent directors and spell out their attributes, role, qualifications, liability and manner of appointment along with the criteria of independence. However, prescription of the number and proportion of such directors in the Board may vary depending on size and type of company and may be prescribed through Rules.

- **Remuneration of Directors**: Decision on remuneration of directors should not be based on a "Government approval based system" but should be left to the company. However, this should be transparent, based on principles that ensure fairness, reasonableness and accountability and should be properly disclosed. No limits need be prescribed. In case of inadequacy of profits also the company to be allowed to pay remuneration recommended by remuneration committee (wherever
Committees: Certain committees to be constituted with participation of independent directors should be mandated for certain categories of companies where the requirement of independent directors is mandated. In other cases, constitution of such committees should be at the option of the company.

Law should specify the manner and composition of various committees of the Board like

(i) Audit Committee;
(ii) Stakeholder’s Relationship Committee; and
(iii) Remuneration Committee, along with obligation on the part of the company to consult them in certain matters.

Disqualification of director: Failure to attend board meetings for a continuous period of one year to be made a ground for vacation of office regardless of whether or not leave of absence was granted to such director. Specific provisions to be made in the Law to regulate the process of resignation by a director.

Board meetings: Board Meetings by electronic means to be allowed. In the case of companies where Independent Directors are prescribed, notice period of 7 days has been recommended for Board Meetings with provisions for holding emergency meetings at a shorter notice. Consent of shareholders by way of special resolution should be mandatory for certain important matters.

Annual General Meetings: Use of postal ballot during meetings of members should be allowed to be more widely used by companies.

Law should provide for voting through electronic mode. AGMs may be held at a place other than place of registered office (in India), provided at least 10% members in number reside at such place.

Small Companies to be given an option to dispense with holding of AGM. Demand for poll to be limited with due regard for minority interests.

Appointment of MD/WTD: Managing Director (MD)/Whole Time Directors (WTD)/Executive Director (ED) should be in the whole-time employment of only one company at a time. Provisions relating to options for appointment of directors though proportionate representation to be continued. Limit of paid up capital under existing section 269 for mandatory appointment of MD/WTD to be enhanced to Rs. 10 crore.

Key managerial Personnel: Every company should be required to appoint, a Chief Executive Officer, Chief Finance Office and Company Secretary as its Key Managerial Personnel whose appointment and removal shall be by the Board of Directors. Special exemptions may be provided for small companies, who may obtain such services, as may be required from qualified professionals in practice.

Corporate Governance Under Companies Act, 2013

The Companies Act, 2013 enacted on August 30, 2013 envisages radical changes in the sphere of Corporate Governance in India. It is set to provide a major overhaul in Corporate Governance norms and have far-reaching implications on the manner in which corporate operates in India. Some of the Provisions of Companies Act, 2013 related to Corporate Governance are:

1. Appointment and maximum tenure of Independent Directors;
2. Appointment of Woman Director;
3. Appointment of Whole time Key Managerial Personnel;
4. Performance Evaluation of the Directors and Board as a whole;

5. 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.

6. Stricter yet forward-looking procedural requirements for Secretarial compliances and ICSI Secretarial Standards made mandatory;

7. Enhanced compliances of Related Party Transactions and introduction of concept of arm’s length pricing;

8. Enhanced restrictions on appointment of Auditors and mandatory rotation of Auditors;

9. Separation of role of Chairperson and Chief Executive Officer;

10. Mandatory provisions regarding vigil mechanism;

11. Constitution of Nomination and Remuneration Committee;

12. Constitution of CSR Committee with minimum one Independent Director and formulation of CSR policy to spend 2% of average Net Profits during the three immediately preceding financial years in pursuance of CSR policy;

13. Secretarial Audit for the bigger companies.

### Corporate Governance for Listed Companies in India

In the year 2000, SEBI (Securities Exchange Board of India) had incorporated clause 49 to the Listing Agreement. SEBI, as part of its endeavour to improve the standards of Corporate Governance in line with the needs of a dynamic market, has amended clause 49 from time to time. In April 2014, SEBI revised clause 49 in line with the norms of Companies Act 2013. Again some amendments were made in September 2014.

Recently, on 2nd September 2015 has notified SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 which shall be applicable from December 2015 for the listed entity who has listed designated securities on recognized stock exchanges. The provisions of Corporate Governance in SEBI (LODR) Regulations 2015 are discussed at relevant places in this study material.

### ELEMENTS OF GOOD CORPORATE GOVERNANCE

Some of the important elements of good corporate governance are discussed as under:

1. **Role and powers of Board**

   Good governance is decisively the manifestation of personal beliefs and values which configure the organizational values, beliefs and actions of its Board. The Board 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 day-to-day basis can be subject to deliberate manipulation or inadvertent misinterpretation.

3. Management environment

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

4. Board skills

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

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

5. Board appointments

To ensure that the most competent people are appointed in 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.

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 materials to directors sufficiently prior to Board meetings.

9. Code of conduct

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

10. Strategy setting

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

11. Business and community obligations

Though basic activity of a business entity is inherently commercial yet it must also take care of community’s obligations. Commercial objectives and community service obligations should be clearly documented after approval by the Board. The stakeholders must be informed about the proposed and ongoing initiatives taken to meet the community obligations.

12. Financial and operational reporting

The Board requires comprehensive, regular, reliable, timely, correct and relevant information in a form and of a quality that is appropriate to discharge its function of monitoring corporate performance. For this purpose, clearly defined performance measures - financial and non-financial should be prescribed which would add to the efficiency and effectiveness of the organisation.

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

13. Monitoring the Board performance

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

14. Audit Committees

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

15. Risk management

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

The Board has the ultimate responsibility for identifying major risks to the organization, setting acceptable levels of risk and ensuring that senior management takes steps to detect, monitor and control these risks. The Board must satisfy itself that appropriate risk management systems and procedure are in place to identify and manage risks. For this purpose the company should subject itself to periodic external and internal risk reviews.

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.

- 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.

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

- 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, 2012 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.

**SELF TEST QUESTIONS**

(i) Discuss in brief the evolution of the concept of Corporate Governance in U.K.

(ii) Discuss briefly the recommendations of the Dr. J.J. Irani Committee on Company Law relating to Management and Board Governance.

(iii) Explain why Corporate Governance is gaining importance.

(iv) What are the elements of Good Corporate Governance?

(v) What are the Basic theories of Corporate Governance?

Go through the following:

(1) http://www.sebi.gov.in/commreport/corpgov.html

(2) www.coso.org

(3) http://www.ecgi.org/codes/documents/cadbury.pdf


(5) http://www.ftse.com/

(6) http://www.nfcgindia.org/library.htm


(8) http://www.ecgen.org

(9) https://frc.org.uk/Home.aspx

Lesson 4
Legislative Framework of Corporate Governance in India

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

- Laisenia Qarase
INTRODUCTION

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

The first initiative on Corporate Governance in Indian Industry was taken by CII. 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. In April 1998, the Desirable Corporate Governance: A Code was released. The code made 16 recommendations pertaining to Frequency of Board meetings, Board Composition, No. of directorships, Role, Responsibilities, Qualifications of Non-executive Directors, Remuneration of non-executive directors, Disclosure of attendance record for reappointment, Key information to the Board, Audit Committee, Disclosure on shareholder information, Consolidated Accounts, Compliance certificate, Disclosures relating to GDR, Funding, Nominee Director, Disclosure of Ratings, default on fixed deposits by company etc.

In the year 2000, SEBI had set up a Committee 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. These recommendations were divided into mandatory and non-mandatory recommendations and were made applicable to all listed companies with the paid-up capital of Rs. 3 crores and above or net worth of Rs. 25 crores or more at any time in the history of the company.

In May 2000, MCA, (then Department of Company Affairs) formed a broad-based study group under the chairmanship of Dr. P.L. Sanjeev Reddy, Secretary, DCA. 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.

The Enron debacle of 2001, 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. led the Indian Government to appoint Naresh Chandra Committee in the year 2002 to examine and recommend amendments to the law involving the auditor-client relationships and the role of independent directors.

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.

In 2004, the Government constituted a committee under the Chairmanship of Dr. J.J. Irani, Director, 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.

In 2013, the Companies Act, 2013 was enacted envisaging radical changes in the sphere of Corporate Governance in India. It provided for a major overhaul in Corporate Governance norms and would have far-reaching implications on the manner in which corporate operates in India. Introduction of mandatory
provisions regarding Whistle Blower Policy, Audit Committee, Nomination and Remuneration Committee, Stakeholders Relationship Committee, and Corporate Social Responsibility Committee, independent directors, woman director, Key Managerial Personnel and Performance Evaluation of the Board etc. are some of the provisions of Companies Act, 2013 related to Corporate Governance.

SEBI vide its circular dated April 17, 2014 came out with ‘Corporate Governance in listed entities - Amendments to Clause 49’ of the Equity Listing Agreement which lays down the detailed corporate governance norms for listed companies providing for stricter disclosures and protection of investor rights, including equitable treatment for minority and foreign shareholders.

In the year 2015, with a view to consolidate and streamline the provisions of existing listing agreements for different segments of the capital market and to align the provision relating to listed entities with the Companies Act 2013, SEBI has notified the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 herein after referred as ‘Listing Regulations’ on September 2, 2015. The new Listing Regulations have been structured to provide ease of reference by consolidating into one single document across various types of securities listed on the Stock exchanges.

**Principles For Periodic Disclosures And For Corporate Governance**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(vi) exercise of ownership rights by all shareholders, including institutional investors.
(vii) adequate mechanism to address the grievances of the shareholders.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(i) Disclosure of information:

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

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

(ii) Key functions of the board of directors:

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

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

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

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

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

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

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

(8) Overseeing the process of disclosure and communications.

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

(iii) Other responsibilities:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

### PROVISIONS OF CORPORATE GOVERNANCE UNDER COMPANIES ACT 2013 AND LISTING REGULATIONS

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Particulars</th>
<th>Companies Act 2013</th>
<th>Listing Regulations</th>
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<tbody>
<tr>
<td>1.</td>
<td><strong>Size of the Board</strong></td>
<td><em>Section 149 (1)</em></td>
<td><em>Regulation 17(1)(a)</em></td>
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<td>It stipulates the minimum number of</td>
<td>The board of directors shall have an optimum</td>
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<td>director as three in case of public</td>
<td>combination of executive and non-executive</td>
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<td>company, two in case of private</td>
<td>directors.</td>
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<td>company and one in case of One</td>
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<td>Person Company. The maximum</td>
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<td>number of directors stipulated is 15.</td>
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<td>2.</td>
<td><strong>Board</strong></td>
<td><em>Section 149(4)</em> provides that every</td>
<td><em>Regulation 17(1)</em></td>
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| Composition | public listed Company shall have at-least one third of total number of directors as independent directors and Central Government may further prescribe minimum number of independent directors in any class or classes of 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. | • At least 50% of the board of directors shall comprise of non-executive directors.  
• If the chairperson of the board of directors is a non-executive director, at least 1/3rd of the board of directors shall comprise of independent directors.  
• If the chairperson of the board of directors is not a non-executive director, at least 50% of the board of directors shall comprise of independent directors.  
• If the regular non-executive chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of board of director or at one level below the board of directors, at least 50% of the board of directors of the listed entity shall consist of independent directors. |
| --- | --- | --- |
| 3. Appointment of Woman Director | Section 149(1) and Companies (Appointment and Qualification of Directors) Rules, 2014  
Rule (3) read with Section 149(1) provides that  
(i) every listed company;  
(ii) every other public company having -  
1. paid–up share capital of Rs.100 crores or more; or  
2. turnover of Rs.300 crore or more shall appoint at least one woman director.  
A company shall comply with provisions within a period of six months from the date of its incorporation. | Regulation 17(1)(a)  
The Board of Directors of the Listed Entity shall have at least one woman director.
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<td>Any intermittent vacancy of a woman director shall be filled up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.</td>
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<td>4.</td>
<td><strong>Maximum No. of directorship of IDs.</strong></td>
<td><strong>Section 165</strong>&lt;br&gt;A person shall not hold office as a director, including any alternate directorship in more than 20 companies at the same time.&lt;br&gt;The max no. of public companies in which a person can be appointed as a director shall not exceed 10.</td>
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<td>5.</td>
<td><strong>Maximum tenure of IDs</strong></td>
<td><strong>Section 149(10) &amp; (11)</strong>&lt;br&gt;Subject to the provisions of Section 152(2), an independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.&lt;br&gt;Any independent director shall hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director.</td>
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<td>6.</td>
<td><strong>Performance evaluation of IDs</strong></td>
<td><strong>Section 178(2) read with Schedule IV</strong>&lt;br&gt;The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board (a) The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors.&lt;br&gt;(b) The Listed Entities shall disclose the criteria for performance evaluation, as laid down by the Nomination</td>
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<td>No.</td>
<td>Section/Regulation</td>
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<td>7.</td>
<td>Section 149 read with Schedule IV</td>
<td><strong>Separate meeting of IDs</strong>&lt;br&gt;IDs of the company shall hold at least one meeting in a year, without the attendance of non independent directors and members of management. All the independent directors of the company shall strive to be present at such meeting. Here, “Year” means Calender year as referred in SS-I.</td>
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<td>8.</td>
<td>Schedule IV specifies that the Independent Directors shall undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company.</td>
<td><strong>Familiarisation Programme for Independent Director</strong>&lt;br&gt;The Listed Entity shall familiarise the independent directors with the Listed Entity, their roles, rights, responsibilities in the Listed Entity, nature of the industry in which the Listed Entity operates, business model of the Listed Entity, etc. The details of such familiarisation programme shall be disclosed on Listed Entity website and a web link thereto shall also be given in the Annual Report.</td>
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<td>9.</td>
<td>Section 197(7)</td>
<td><strong>Prohibited Stock options for IDs</strong>&lt;br&gt;IDs shall not be entitled to any stock option.</td>
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<td>Filing of Casual Vacancy of IDs</td>
<td><strong>Schedule IV, Section VI</strong></td>
<td><strong>Regulation 25(6)</strong></td>
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<td>Second proviso to Rule 4 of Chapter Appointment of Directors states that any intermittent vacancy of an independent director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy, whichever is later.</td>
<td>An independent director who resigns or is removed from the Board of the Listed Entity shall be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later.</td>
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<td>An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within a period of not more than one hundred and eighty days from the date of such resignation or removal, as the case may be.</td>
<td>Provided that, where the Listed Entity fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.</td>
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<td>Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new Independent Director shall not apply.</td>
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<th>11. Succession planning</th>
<th>There is no such provision.</th>
<th><strong>Regulation 17(4)</strong></th>
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<td>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.</td>
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<tr>
<th>12. Code of Conduct of Board of Directors &amp; Senior Management</th>
<th><strong>Section 149(8)</strong> provides that the company and the independent directors shall abide by the provisions specified in Schedule IV.</th>
<th><strong>Regulation 17(5)</strong></th>
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<tr>
<td>The board shall lay down a code of conduct for all Board members and seniors management of the Listed Entity. The code of conduct shall be posted on the website of the Listed Entity. All Board members and senior management personnel shall affirm compliance with the code on an annual</td>
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<tr>
<td><strong>13. Liability of IDs</strong></td>
<td><strong>Section 149(12)</strong></td>
<td><strong>Regulation 25(5)</strong></td>
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<td>An independent director; a NED not being promoter or KMP, 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.</td>
<td>An independent director shall be held liable, only in respect of such acts of omission or commission by a Listed Entity which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the Listing Agreement.</td>
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<td><strong>Regulation 17(5)(b)</strong> states that the Code of Conduct shall suitably incorporate the duties of independent directors as laid down in the Companies Act, 2013.</td>
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<td><strong>14. Vigil mechanism</strong></td>
<td><strong>Section 177(9) read with Rule 7 of Companies (Meeting of Board and its Power) Rules, 2014</strong></td>
<td><strong>Regulation 22</strong></td>
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<td>Every listed company or such class or classes of companies to establish a Vigil mechanism for directors and employees to report genuine concern.</td>
<td>The Listed Entity shall establish a vigil mechanism for directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the Listed Entity code of conduct or ethics policy.</td>
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<td>The details of establishment of Vigil mechanism shall be disclosed by the company in the website, if any, and in the Board’s Report.</td>
<td>This mechanism should also provide for adequate safeguards against victimization of director(s)/employee(s) who avail of the mechanism and also provide for direct access to the chairperson of the Audit Committee in exceptional cases.</td>
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<td><strong>Rule 7 of Companies (Meeting of Board and its Power) Rules, 2014</strong> states that 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 basis. The Annual Report of the Listed Entity shall contain a declaration to this effect signed by the CEO.</td>
<td>The details of establishment of such mechanism shall be disclosed by the Listed Entity on its website and in the Board’s report.</td>
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<td>15.</td>
<td>Qualification of IDs</td>
<td>Rule 5 of Companies (Appointment and Qualification of Directors) Rules, 2014</td>
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<td>An independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company’s business.</td>
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<td>The qualifications of IDs are not specified in the Listed Regulation.</td>
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| 16. | Constitution of Audit Committee | Section 177 read with Rule 6 of Companies (Meeting of Board and Its Powers) Rules, 2014 |
|     |                                 | A listed Entity shall set up a qualified and independent audit committee shall be set up, giving the terms of reference subject to the following: |
|     |                                 | 1. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors. |
|     |                                 | 2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise. |
|     |                                 | 3. The chairperson of the Audit Committee shall be an |
17. Constitution of Nomination & Remuneration Committee

Section 178 and Rule 6 of Companies (Meetings of Board and its Powers) Rules, 2014

The Board of directors of every listed companies and such class or classes of companies as prescribed under Rule 6, shall constitute a Nomination and Remuneration Committee of the Board.

The above mentioned companies shall constitute the Nomination and Remuneration Committee consisting of 3 or more non-executive directors out of which not less than one half shall be IDs.

The chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.

The 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, carry out evaluation of every director’s performance.
- 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.

Regulation 19

The Listed Entity through its Board of directors shall constitute the nomination and remuneration committee which shall comprise at least 3 directors, all of whom shall be non-executive directors and at least ½ shall be independent.

A. Chairperson of the 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 but shall not chair such Committee.

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

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, KMP and other employees;
2. Formulation of criteria for evaluation of IDs and the Board;
3. Devising a policy on Board diversity;
4. Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The Listed Entity shall disclose the remuneration policy and the evaluation criteria in its Annual Report.
The Nomination and Remuneration Committee shall while formulating the policy ensure that—

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

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

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

The policy shall be disclosed in the Board’s report.

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

However, it would be up to the Chairperson to decide who should answer the queries.

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<th>18.</th>
<th>Risk management</th>
<th>Section 134(3)(n)</th>
<th>Regulation21</th>
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<td>The Board’s report as prescribed under Section 134(3) required to include in the Board’s Report, a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, this in the opinion of the Board may threaten the existence of the company.</td>
<td>The top 100 Listed entities, determined on the basis of market capitalisation shall lay down procedures to inform Board members about the risk assessment and minimization procedures. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the Listed Entity. The Listed Entity through its Board of Director shall constitute a Risk Management Committee. The Board shall define the roles and responsibilities of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the</td>
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committee and such other functions as it may deem fit.

The majority of Committee shall consist of members of the Board of Directors.

Senior executives of the Listed Entity may be members of the said Committee but the Chairperson of the Committee shall be a member of the Board of Directors.

18. **Related Party**

   **Section 2(76)**

   “Related party”, with reference to a company, means—
   
   I. a director or his relative
   
   II. a KMP or his relative;
   
   III. a firm, in which a director, manager or his relative is a partner;
   
   IV. a private company in which a director or manager or his relative is a member or director;
   
   V. a public company in which a director or manager is a director and holds along with his relatives, more than 2% of its paid-up share capital;
   
   VI. anybody corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;
   
   VII. any person on whose advice, directions or instructions a director or manager is accustomed to act;
   
   VIII. any company which is—
   
   (A) a holding, subsidiary or an associate company of such

   **Clause 2(zb)**

   For the purpose of Listing Regulation, an entity shall be considered as related to the Listed Entity if:

   Such entity is a related party under Section 2(76) of the Companies Act, 2013; or

   Such entity is a related party under the applicable accounting standards.
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(1) Every listed company shall disclose in the Board’s report:
   i. The ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year.
   ii. the percentage increase in remuneration of each director, CFO, CEO, CS or Manager, if any, in the financial year;
   iii. the percentage increase in the median remuneration of employees in the financial year;
   iv. the number of permanent employees on the rolls of company;
   v. the explanation on the relationship between average increase in remuneration and company performance;
   vi. comparison of the remuneration of the KMP against the performance of the company;
   vii. variations in the market capitalisation of the company, price earnings ratio as at the closing date of the current financial year and previous financial year and percentage increase over decrease in the market quotations of the shares of the company in comparison to the rate at which the company came out with the last public offer in case of listed companies, and in case of unlisted companies, the variations in the net worth of the company as at the close of the current financial year and previous financial year;
   viii. average percentile increase executive directors vis-à-vis the Listed Entity shall be disclosed in the Annual Report.

2. In addition to the disclosures required under the Companies Act, 2013, the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report:
   a. All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc.
   b. Details of fixed component 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.

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

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

5. Non-executive directors shall be required to disclose their shareholding (both own or held
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<th>23.</th>
<th><strong>Stakeholders Relationship Committee</strong></th>
<th><strong>Section- 178(5)&amp;(6)</strong></th>
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<td>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;</td>
<td>These details should be disclosed in the notice to the general meeting called for appointment of such director.</td>
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<td>ix. comparison of the each remuneration of the Key Managerial personnel against the performance of the company.</td>
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<td>x. the key parameters for any variable component of remuneration availed by the directors;</td>
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<td>xi. the ratio of the remuneration of the highest paid director to that of the employees who are not directors but receive remuneration in excess of the highest paid director during the year; and</td>
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<td>xii. Affirmation that the remuneration is as per the remuneration policy of the company.</td>
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Relationship Committee shall consider and resolve the grievances of security holders of the company.

holders of the Listed Entity including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends.

DISCLOSURE AND TRANSPARENCY REQUIREMENTS UNDER COMPANIES ACT 2013 AND SEBI REGULATIONS

1. IN TERMS OF COMPANIES ACT, 2013

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

A. Disclosures under Section 134 of Companies Act 2013

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

(a) the extract of the annual return as provided under Section 92(3)
(b) number of meetings of the Board;
(c) Directors’ Responsibility Statement
(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 has been made by the Board of its own performance and that of its committees and individual directors;

(q) such other matters as may be prescribed.

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; and

(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;

(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

(a) Section 178(4) states that the Board's Report shall include a policy formulated by Nomination and Remuneration Committee. The policy shall ensure that: the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully.

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

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

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

Under section 177(8), Board’s Report shall disclose the composition of audit committee and shall also disclose the recommendation of the audit committee which is not accepted by the board along with reasons thereof.
Proviso to section 177(10) prescribes the inclusion of the details of establishment of vigil mechanism under section 177(9) in the Board’s Report.

With the e-filing of forms with the Registrar of Companies, The Ministry of Corporate Affairs has put in place a mechanism that is imaginative, technologically savvy and stakeholder friendly. Through the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance, the MCA aims at moving from paper based to nearly paperless environment.

As per section 204(1) every listed company and other prescribed companies in Rule 9 Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014 shall annex the secretarial audit report given by a Company Secretary in practice with Board’s Report. Board in its report shall explain any qualification or observation or other remarks made by the Company Secretary in Practice.

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

Section 134(8) states that if a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakhs rupees. Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakhs rupees, or with both

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

A. Companies (Accounts) Rules 2014

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

(1) The Board’s Report shall be prepared based on the stand alone financial statements of the company and the report shall contain a separate section wherein a report on the performance and financial position of each of the subsidiaries, associates and joint venture companies included in the consolidated financial statement is presented.

(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 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.

(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) 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) the explanation on the relationship between average increase in remuneration and company performance;

(vi) comparison of the remuneration of the Key Managerial Personnel against the performance of the company;
(vii) variations in the market capitalisation of the company, price earnings ratio as at the closing date of the current financial year and previous financial year and percentage increase over decrease in the market quotations of the shares of the company in comparison to the rate at which the company came out with the last public offer in case of listed companies, and in case of unlisted companies, the variations in the net worth of the company as at the close of the current financial year and previous financial year;

(viii) 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;

(ix) comparison of the each remuneration of the Key Managerial Personnel against the performance of the company;

(x) the key parameters for any variable component of remuneration availed by the directors;

(xi) the ratio of the remuneration of the highest paid director to that of the employees who are not directors but receive remuneration in excess of the highest paid director during the year; and

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

D. Companies (Appointment and Remuneration) Rules, 2014: The rule prescribes following disclosure on ratio of remuneration of each Director to the median employee’s remuneration :-

Rule 5 (1) prescribes that Every listed company shall disclose in the Board’s report-

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

(ii) the percentage increase in remuneration of each director, 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) the explanation on the relationship between average increase in remuneration and company performance;

(vi) comparison of the remuneration of the Key Managerial Personnel against the performance of the company;

(vii) variations in the market capitalisation of the company, price earnings ratio as at the closing date of the current financial year and previous financial year and percentage increase over decrease in the market quotations of the shares of the company in comparison to the rate at which the company came out with the last public offer in case of listed companies, and in case of unlisted companies, the variations in the net worth of the company as at the close of the current financial year and previous financial year;

(viii) 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;

(ix) comparison of the each remuneration of the Key Managerial Personnel against the performance of
the company;

(x) the key parameters for any variable component of remuneration availed by the directors;

(xi) the ratio of the remuneration of the highest paid director to that of the employees who are not directors but receive remuneration in excess of the highest paid director during the year; and

(xii) 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 (1) prescribes that the board’s report shall include a statement showing the name of every employee of the company, who-

(i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than sixty 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 five lakh 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.

E. Companies (Corporate Social Responsibility) Rules, 2014

Rule 8 of 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 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.

Disclosures: Under Companies Act, 2013, the companies are required to make certain disclosures in the annual return and director’s report.

4. DISCLOSURES IN TERMS OF SEBI REGULATIONS

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

Filing of offer document (Regulation 6)

No issuer shall make,

(a) a public issue; or

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

Unless a draft offer document, along with fees as specified in Schedule IV, has been filed with the Board 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. Further, disclosure has to be made to the public.

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.

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. The lead merchant banker shall submit post-issue reports to the Board as follows:
   (a) initial post issue report in specified format, within three days of closure of the issue
   (b) final post issue report in specified format, within fifteen days of the date of finalisation of basis
       of allotment or within fifteen days of refund of money in case of failure of issue.

2. 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 despatch of refund orders or instructions to Self
   Certified Syndicate Banks by the Registrar, date of despatch 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.

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

Upon receipt of the disclosures required under this Chapter, the stock exchange shall forthwith disseminate
the information so received.
Disclosure of acquisition and disposal (Regulation 29)

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

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

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

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

(b) the target company at its registered office.

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

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

Continual disclosures (Regulation 30)

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

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

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

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

(b) the target company at its registered office.

Disclosure of encumbered shares (Regulation 31)

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

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

3. The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within seven working days from the creation or invocation or release of encumbrance, as the case may be to,—

(a) every stock exchange where the shares of the target company are listed; and
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(b) the target company at its registered office.

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

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

PRIOR INTIMATIONS (REGULATION 29)

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

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

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

- the proposal for declaration of bonus securities where such proposal is communicated to the board of directors of the listed entity as part of the agenda papers.

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

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

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

- any alteration in the form or nature of any of its securities that are listed on the stock exchange or in the rights or privileges of the holders thereof.

- any alteration in the date on which, the interest on debentures or bonds, or the redemption amount of redeemable shares or of debentures or bonds, shall be payable.

**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.

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

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;
- consolidated financial statements audited by its statutory auditors;
- cash flow statement presented only under the indirect method as prescribed in Accounting Standard-
  3 or Indian Accounting Standard 7, as applicable, specified in Section 133 of the Companies Act, 2013 read
  with relevant rules framed thereunder or as specified by the Institute of Chartered
  Accountants of India, whichever is applicable;
- directors report;
- management discussion and analysis report - either as a part of directors report or addition thereto;
- Business Responsibility Reports
Additional Disclosures in Annual Report

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

A. Related Party Disclosure:

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

2. The disclosure requirements shall be as follows:

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

For the purpose of above disclosures directors’ interest shall have the same meaning as given in Section 184 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 nonexecutive directors;
- web link where details of familiarisation programmes imparted to independent directors is disclosed.

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

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

(5) Remuneration of Directors:
- all pecuniary relationship or transactions of the non-executive directors vis-à-vis the listed entity shall be disclosed in the annual report;
- criteria of making payments to non-executive directors. alternatively, this may be disseminated on the listed entity’s website and reference drawn thereto in the annual report;
- disclosures with respect to remuneration: in addition to disclosures required under the Companies Act, 2013, the following disclosures shall be made:
  (i) all elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc;
  (ii) details of fixed component and performance linked incentives, along with the performance criteria;
(iii) service contracts, notice period, severance fees;
(iv) stock option details, if any and whether issued at a discount as well as the period over which accrued and over which exercisable.

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

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

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

(9) General shareholder information:
- annual general meeting - date, time and venue;
- financial year;
- dividend payment date;
- the name and address of each stock exchange(s) at which the listed entity's securities are listed and a confirmation about payment of annual listing fee to each of such stock exchange(s);
- stock code;
- market price data- high, low during each month in last financial year;
- performance in comparison to broad-based indices such as BSE sensex, CRISIL Index etc;
- 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 made by the listed entity to
analysts or institutional investors simultaneously with submission to stock exchange;
(p) new name and the old name of the listed entity for a continuous period of one year, from the date of
the last name change;
(q) following information published in the newspaper-
- notice of meeting of the board of directors where financial results shall be discussed
- financial results, as specified in regulation 33, along-with the modified opinion(s) or reservation(s), if any, expressed by the auditor: Provided that if the listed entity has submitted both standalone and consolidated financial results, the listed entity shall publish consolidated financial results along-with (1) Turnover, (2) Profit before tax and (3) Profit after tax, on a standalone basis, as a footnote; 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;

SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

DISCLOSURES OF TRADING BY INSIDERS

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

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

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

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

Disclosures by certain persons –

Initial Disclosure. Regulation 7 (1)

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

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

Continual Disclosures : Regulation 7(2)

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

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

Disclosures by other connected persons.

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

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

Code of Fair Disclosure (Regulation 8)

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

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

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

This provision is aimed at requiring transparent disclosure of the policy formulated in sub-regulation (1).

SCHEDULE A [Sub-regulation (1) of regulation 8]:


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

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

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

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

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

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

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

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

### RELATED PARTY TRANSACTIONS

#### Meaning of related party

Regulation 2(1) (zb) 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.

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;

(x) the Companies (Specification of Definitions details) Rules 2014, a director other than an independent director or KMP of the holding company or his relative with reference to a company shall deemed to be related party.
As per Ind AS-24 A related party is a person or entity that is related to the entity that is preparing its financial statements (i.e. the ‘reporting entity’)

(a) A person or a close member of that person’s family is related to a reporting entity if that person:
   (i) has control or joint control over the reporting entity;
   (ii) has significant influence over the reporting entity; or
   (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:
   (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
   (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
   (iii) Both entities are joint ventures of the same third party.
   (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
   (v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
   (vi) The entity is controlled or jointly controlled by a person identified in (a).
   (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity)

As per Accounting Standard 18

Related party - parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Definition of related party transaction

Regulation 2(1) (zc) defines that “related party transaction” means a transfer of resources, services or obligations between a listed entity and a related party, regardless of whether a price is charged and a “transaction” with a related party shall be construed to include a single transaction or a group of transactions in a contract.

Definition of relative

Regulation 2(1) (zd) specifies that “relative” means relative as defined under Section 2(77) of the Companies Act, 2013 and rules prescribed there under.

Thus, accordingly “relative”, with reference to any person, means any one 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.

Policy on materiality of related party transactions: The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions.

When will a transaction with a related party be material?

A transaction with a related party shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds 10% of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

Approval of Audit Committee

All related party transactions shall require prior approval of the audit committee.

Omnibus Approval: Audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity subject to the following conditions-

(a) the audit committee shall lay down the criteria for granting the omnibus approval in line with the policy on related party transactions of the listed entity and such approval shall be applicable in respect of transactions which are repetitive in nature;

(b) the audit committee shall satisfy itself regarding the need for such omnibus approval and that such approval is in the interest of the listed entity;

(c) the omnibus approval shall specify:

(i) the name(s) of the related party, nature of transaction, period of transaction, maximum amount of transactions that shall be entered into,

(ii) the indicative base price / current contracted price and the formula for variation in the price if any; and

(iii) such other conditions as the audit committee may deem fit

provided where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may grant omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.

(d) the audit committee shall review, at least on a quarterly basis, the details of related party transactions entered into by the listed entity pursuant to each of the omnibus approvals given.

(e) Such omnibus approvals shall be valid for a period not exceeding one year and shall require fresh approvals after the expiry of one year.

Approval of the shareholders

All material related party transactions shall require approval of the shareholders through resolution and the
related parties shall abstain from voting on such resolutions whether the entity is a related party to the particular transaction or not.

**Exceptions**

The approval of Audit committee and shareholders shall not be required in the following cases:

(a) transactions entered into between two government companies;

(b) transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

"Government company(ies)" means Government company as defined in sub-section (45) of section 2 of the Companies Act, 2013.

**Other provisions**

- The provisions of this regulation shall be applicable to all prospective transactions.
- For the purpose of this regulation, all entities falling under the definition of related parties shall abstain from voting irrespective of whether the entity is a party to the particular transaction or not.
- 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.

### LESSON ROUND-UP

- Legal and regulatory framework of corporate governance in India is mainly covered under the Companies Act, 2013, Listing Agreement and SEBI guidelines. However, it is not restricted to only SEBI Guidelines and the Companies Act, 2013. A gamut of legislations like The Competition Act, the Consumer Protection laws, the labour laws, the environment laws, the Money Laundering Laws etc seeks to ensure good governance practices among the corporates.

- The Securities and Exchange Board of India (SEBI) is the prime regulatory authority which regulates all aspects of securities market enforces the Securities Contracts (Regulation) Act including the stock exchanges. Companies that are listed on the stock exchanges are required to comply with the Listing Agreement.

- The following are the major legislations/regulations/guidelines on transparency and disclosure
  - Companies Act 2013
  - SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009
  - SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
  - SEBI (Prohibition of Insider Trading) Regulations, 2015
  - SEBI Listing Regulations 2015
SELF TEST QUESTIONS

1. Describe how the Indian Legislative framework supports transparency and disclosure by corporates.

2. Write a brief note on
   (a) Regulators and regulations in India pertaining to Corporate Governance
   (b) Disclosures to be made under Listing Regulations, 2015.
   (c) Shareholders rights

3. What is the provision for Board composition in the Listing Regulations, 2015?

4. Explain the Role and Importance of Remuneration Committee.

5. Write short notes on the following:
   • Whistle Blower Policy/Mechanism
   • Disclosure under Corporate Governance Report
   • Separation of Role of Chairman and CEO
   • Independent Director
Lesson 5
Board Effectiveness- Issues and Challenges

LESSON OUTLINE

- Introduction
- Role of Directors
- Types of Board
- Governance Functionaries
- Board Composition
- Board Charter
- Board Processes
- Responsibilities of Board
- Responsibility for Leadership
- Difference between directors and managers
- Barrier to Visionary Leadership
- Training of Directors
- Board Evaluation & Performance Review
- Conclusion
- Lesson Round-Up
- Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand the Board Composition and its effectiveness and various issues and challenges to board effectiveness through four well divided segments.

The first segment of the study enables the students to understand the role of directors, types of boards, diversity in Boardrooms, Governance Functionaries, Chairman & Chief Executive Officer, separation of Power and Lead Independent Director; The second segment of the study focuses on Board processes & Board Charter.

The third segment of the study enables the students to understand the concept of Board responsibility, Leadership Development, Relationship between Directors and Executives, The key difference between Directors and Managers, Barriers to Visionary Leadership and related matters.

The last segment of this study enables the students to understand the – importance of Director Induction and Development programmes, Performance Review of Board & Individual Directors, Major Factors for Evaluation, Parameters and Model questions for Evaluation purpose.

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

The contribution of directors on the Board of companies is critical for ensuring appropriate directions with regard to leadership, vision, strategy, policies, monitoring, supervision, accountability to shareholders and other stakeholders, and to achieving greater levels of performance on a sustained basis as well as adherence to the best practices of corporate governance.

The institution of board of directors was based on the premise that a group of trustworthy and respectable people should look after the interests of the large number of shareholders who are not directly involved in the management of the company. The position of the board of directors is that of trust as the board is entrusted with the responsibility to act in the best interests of the company.

The board’s role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed.

The Board of Directors plays a pivotal role in ensuring good governance. The contribution of directors on the Board is critical to the way a corporate conducts itself. A board’s responsibilities derive from law, custom, tradition and current practice. In the present times transparency, disclosure accountability, issues of sustainability, corporate citizenship, globalization are just some of the concerns that the Boards have to deal with. In addition, the Boards have to respond to the explosive demands of the marketplace. This two dimensional role of the Board of Directors is the cornerstone in evolving a sound, efficient, vibrant and dynamic corporate sector for attaining of high standards in integrity, transparency, conduct, accountability as well as social responsibility.

**SEGMENT I - ROLE OF DIRECTORS**

To establish the Vision & Mission Statement: Approval of company’s philosophy, vision and mission statement is done by the board of directors. While doing so, it must be discerned that the company’s activities are consistent with its stated purpose. The Board ensures that the company effectively and efficiently works towards achieving its mission and is committed to continual quality improvement. Based on the value of quality, openness, integrity, responsibility and accountability, board members and employees should act in the best interest of achieving the company’s mission at all times.
Strategic Direction and advice: Board is to review and approve management’s strategy, plans and decisions, financial objectives and extraordinary business transactions. Boards are in an excellent position to provide input and advice to the CEO and the top management regarding the company’s strategic direction. They can contribute opinions, viewpoints and information that are not always readily available to the company’s management. As the directors are not involved in day-to-day development of strategy, they are in a position to provide an objective and detached view of its potential effectiveness.

Overseeing Strategy Implementation and performance: Developing a valid strategy is only the first step in creating an effective organization. The board plays a crucial role in advising, evaluating and monitoring strategy implementation. Boards can best monitor strategy implementation by setting benchmarks to measure progress and by drawing on objective sources of information.

Appointing and evaluation of CEO and Senior management: It is the duty as well as the power of the Board to appoint the CEO, other officers to the senior management and specialist officers of the company. Boards need to be proactive in evaluating the performance of CEO and top management team. The Board has to be involved in planning the development of senior management. The board has responsibility for

→ Hiring the senior managerial personnel;
→ Giving direction to the senior managerial personnel, and;
→ Evaluating the senior managerial personnel.

Ensuring Stakeholder Relations: To serve as a communications link with members and other stakeholders of an organization - organization can accomplish this by informing people of upcoming events, promoting items of interest and providing newsworthy information.

To serve as a communication link with the general public- Promote the organization’s purpose, goals and objectives, programmes and activities before the public to foster awareness, accomplishments and opportunities for involvement.

Risk Mitigation: Directors are expected to identify and manage obstacles that may prevent the organization from reaching its goals. The entire board must be involved in risk management, particularly around financial matters and legal compliance. In managing risk, directors have a responsibility to owners to foresee what could affect the organization and to put in place plans that will minimise the impact of events or changes that will have a negative effect. Each company will have a different risk profile and appetite. Each board will identify the key risks affecting their own sector and then take steps to manage those risks.

Procuring resources: Financial resources, human resources, technological resources and business relationship are the key resources that are essential to an organization’s success. Boards play an important role in helping the organization in procuring the resources.

Who are 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.”
TYPES OF BOARD

Unitary Board

The unitary board, remains in full control of every aspect of the company’s activities. It initiates action and it is responsible for ensuring that the action which it has initiated is carried out. All the directors, whether executive or outside, share the same aims and responsibilities and are on the same platform.

Two-tier Boards

The alternative board model to unitary board is the two-tier board, which was developed in its present form in Germany. A two-tier board fulfils the same basic functions as a unitary board, but it does so through a clear separation between the tasks of monitoring and that of management. The supervisory board (Asfusichtsrat) oversees the direction of the business and the management board (Vorstand) is responsible for the running of the company. The supervisory board controls the management board through appointing its members and through its statutory right to have the final say in major decisions affecting the company. The structure rigorously separates the control function from the management function and members of the one board cannot be members of the other. This separation is enshrined in law and the legal responsibilities of the two sets of board members are different. The supervisory board system was introduced to strengthen the control of shareholders, particularly the banks, over the companies in which they had invested. Shareholdings are more concentrated in Germany and most quoted companies have at least one major shareholder, often a family or another company. Banks play an important part in governance as investors, lenders and through the votes of individual shareholders for which they hold proxies. They are, therefore, well represented on supervisory boards.

Who are Directors?

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

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

GOVERNANCE FUNCTIONARIES

1. Executive Director

The term executive director is usually used to describe a person who is both a member of the board and who also has day to day responsibilities in respect of the affairs of the company. Executive directors perform operational and strategic business functions such as:

→ managing people
→ looking after assets
→ hiring and firing
→ entering into contracts

Executive directors are employed by the company and paid a salary, so are protected by employment law. Examples of executive directors are production director, finance director or managing director or whole time director.
Section 2(54) of the Companies Act, 2013 defines Managing Director as: "managing director" means a director who, by virtue of articles of a company or an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of a managing director, by whatever name called.

The explanation to section 2(54) excludes administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, from the substantial powers of management.

2. Non Executive Director

They are not in the employment of the company. They are the members of the Board, who normally do not take part in the day-to-day implementation of the company policy. They are generally appointed to provide the company with the benefits of professional expertise and outside perspective to the board. They play an effective role in governance of listed companies, but they may or may not be independent directors.

3. Shadow Director

Shadow Director is a person who is not formally appointed as a director, but in accordance with whose directions or instructions the directors of a company are accustomed to act. This is a concept adopted from English law. However, a person is not a shadow director merely because the directors act on advice given by him in a professional capacity.

Holder of controlling or majority stock (share) of a private firm who is not (technically) a director and does not openly participate in the firm’s governance, but whose directions or instructions are routinely complied with by the employees or other directors. In the eyes of law, he or she is a de facto director and is held equally liable for the obligations of the firm with the other de facto and de jure directors.

Can a shadow director be counted for the Board Quorum?

4. Woman Director

Second Proviso to section 149 provides that such class or classes of companies as may be prescribed in Companies (Appointment and Qualification of Directors) Rules, 2014, shall have at least one woman director.

Rule 3 of Companies (Appointment and Qualification of Directors) Rules, 2014, prescribes the following class of companies shall appoint at least one woman director-

(i) every listed company;

(ii) every other public company having :-

(a) paid–up share capital of one hundred crore rupees or more; or
(b) turnover of three hundred crore rupees or more.

A company, which has been incorporated under the Act and is covered under provisions of second proviso to sub-section (1) of section 149 shall comply with such provisions within a period of six months from the date of its incorporation:

However any intermittent vacancy of a woman director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.

Explanation.- For the purposes of this rule, it is hereby clarified that the paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

Regulation 17(i) of the SEBI (LODR) Regulations also requires that at least one woman director shall be appointed on the board of all listed entities.

5. Resident Director

Section 149 (3) of the Act has provided for residence of a director in India as a compulsory i.e. every company shall have at least one director who has stayed in India for a total period of not less than 182 days in the previous calendar year. MCA has also issued clarification with regard to Resident Directors.

**Clarification by MCA**

1. Whether the provision regarding Resident Director is applicable in the current calendar/financial year.

   - The matter has been examined. It has been clarified that the, residency requirement' would be reckoned from the date of commencement of section 14 of the Act i.e. 1st April, 2014. The first previous calendar year, for compliance with these provisions would, therefore, be Calendar year 2014. The period to be taken into account for compliance with these provisions will be the remaining period of calendar year 2014 i.e. 1st April to 31st December). Therefore, on a proportionate basis the number of days for which the director(s) would need to be resident in India during Calendar year,2014, shall exceed 136 days.

   - Regarding newly incorporated companies it is clarified that companies incorporated between 1.4.2014 to 30.9.2014 should have a resident director either at the incorporation stage itself or within six months of their incorporation. Companies incorporated after 30.9.2014 need to have the resident director from the date of incorporation itself.

6. Independent Director

As per section 2(47) of the Companies Act, 2013, “independent directors” means an independent director referred to in sub-section (6) of section 149

The word ‘independent’ with reference to board composition was used for the first time in corporate legislation in relation to investment companies by a Report that introduced the Investment Company Act, 1940. It suggested that at least 40 percent of the Board of directors of an investment company shall be Independent for safeguarding the investors.

In United Kingdom, in 1973, Lord Watkinson was appointed by Confederation of British Industry to make recommendations on a more responsible corporate sector. He submitted his report titled ‘Responsibilities of the British Public Company’, which recommended appointment of non-executive directors to the Board.
Role of Independent Director

Independent directors are known to bring an objective view in board deliberations. They also ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict of interest.

Independent Directors bring a valuable outside perspective to the deliberations. They contribute significantly to the decision-making process of the Board. They can bring 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.

CII Task Force report entitled “Desirable Corporate Governance: A Code” in 1998 and SEBI’s Kumar Mangalam Birla Committee Report, 1999 initiated the concept of Independent Directors in India. The CII’s Task Force and the Kumar Mangalam Birla Committee extensively debated the issue of independent directors. The Task Force said in its report that “the identities of members of Board crucial to excellence is of course obvious. Equally vital, however are their individual competencies, experience and track record, which must match the business that the company is in. And a mix of operational managers, who have the insider’s perspective and external professionals, who bring in the outsider’s cool detachment, will provide the collective capability that a Board needs.”

Kumar Mangalam Birla Committee agreed on the following definition of “Independence”:

“Independent directors are directors who apart from receiving director’s remuneration do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the Board may affect their independence of judgment”.

The Naresh Chandra Committee defined an independent director as follows:—

An independent director of a company is a non-executive director who:

1. Apart from receiving director’s remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;
2. Is not related to promoters or management at the Board level, or one level below the Board (spouse and dependent, parents, children or siblings);
3. Has not been an executive of the company in the last three years;
4. Is not a partner or an executive of the statutory auditing firm, the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a
material association with the entity;

5. Is not a significant supplier, vendor or customer of the company;

6. Is not a substantial shareholder of the company, i.e. owing two per cent or more of the block of voting shares;

7. Has not been a director, independent or otherwise, of the company for more than three terms of three years each (not exceeding nine years in any case):

An employee, executive director or nominee of any bank, financial institution, corporations or trustees of debenture and bond holders, who is normally called a “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.

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 with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year; (This provision does not apply to Government Companies).

Clarification by MCA

1. Whether a transaction entered into by an Independent Director with the company concerned at par with any member of the general public and at the same price as is payable/paid by such member of public would attract the bar of ‘pecuniary relationship’ under section 149(6)(c).

It has been clarified that in view of the provisions of section 188 which take away transactions in the ordinary course of business at arm's length price from the purview of related party transactions, an Independent Director will not be said to have ‘pecuniary relationship’, under section 149(6)(c) in such cases.

2. Whether receipt of remuneration, (in accordance with the provisions of the Act) by an Independent Director from a company would be considered as having pecuniary interest while considering his appointment in the holding company, subsidiary company or associate company of such company.

The matter has been examined in consultation with SEBI and it has been clarified that ‘pecuniary relationship’ provided in section 149(6)(c) of the Act does not include receipt of remuneration, from one or more companies, by way of fee provided under sub-section (5) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission approved by the members, in accordance with the provisions of the Act.

(d) none of whose relatives has or had pecuniary relationship or transaction with the company, 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;

(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;

(ii) is or has been an employee or proprietor or a partner, in any of the three financial
years immediately preceding the financial year in which he is proposed to be appointed, of—

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or
its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its
holding, subsidiary or associate company amounting to ten per cent. or more of the
gross turnover of such firm;

(iii) holds together with his relatives two per cent. or more of the total voting power of the
company; or

(iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that
receives twenty-five per cent. or more of its receipts from the company, any of its promoters,
directors or its holding, subsidiary or associate company or that holds two per cent. or more
of the total voting power of the company; or

(f) who possesses such other qualifications as may be prescribed.

Meaning of Independent Director under Regulation 16(1)(b) of SEBI (LODR) Regulations

The expression ‘independent director’ shall mean a non-executive director, other than a nominee director
of the listed entity.

(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;

(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.

**Explanation** — for the purposes of this section, “nominee director” means a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests.

**Which Companies are required to appoint Independent Director?**

Section 149(4) read with Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 provides that every listed company shall have at least one-third of the total number of directors and the following class or classes of Companies shall have at least two directors as independent directors-

(i) The Public Companies having paid up share capital of ten crore rupees or more; or

(ii) The Public Companies turnover of one hundred crore rupees or more; or

(iii) The Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees:

The provision of independent director shall not apply to Section 8 Companies.

**What are the Qualifications of an Independent Director?**

Rule 5 of Companies (Appointment and Qualification of Directors) Rules, 2014 made under Chapter XII provides that an independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company’s business.

**What is the Manner of selection of an Independent Director?**

According to section 150 (1) of the Act, independent directors may be selected from a data bank of eligible and willing persons maintained by the agency (any body, institute or association as may be authorised by Central Government). Such agency shall put data bank of independent directors on the
This section further stipulates that the appointment of independent directors has to be approved by members in a General meeting and the explanatory statement annexed to the notice must indicate justification for such appointment.

Any person who desires to get his name included in the data bank of independent directors shall make an application to the agency for inclusion of name in the databank of Independent Directors which includes the personal, educational, professional, work experience, other Board details of the applicant (Rule 6(4)).

The agency may charge a reasonable fee from the applicant for inclusion of his name in the data bank of independent directors [Rule 6 (5)]

An existing or applicant of such data bank of independent directors shall intimate any changes in his particulars within fifteen days of such change to the agency (Rule 6 (6)).

Rule 6 (7) prescribed that the databank posted on the website shall:

a. be accessible at the specified website;

b. be substantially identical to the physical version of the data bank;

c. be searchable on the parameters specified in rule 6 (2);

d. be presented in a format or formats convenient for both printing and viewing online; and

e. contain a link to obtain the software required to view print the particulars free of charge.

The Institute of Chartered Accountants of India, The Institute of Company Secretaries of India and the Institute of Cost Accountants of India under the active encouragement of Ministry of Corporate Affairs, Government of India has developed Independent Directory Repository to facilitate Companies to select the persons who are eligible and willing to act as Independent Directors.

What is Declaration of Independence?

A statement/declaration by an independent director that he meets the criteria of independence is a good governance practice. Companies are encouraged to obtain such a certificate at the time of appointment as well as annually. There is always a possibility that independent director losses his independent status while holding his office. In such a situation the director must approach the Board and communicate his status. In turn, the company is expected to make adequate disclosures to the shareholders.

Section 149(7) of Companies Act, 2013 states that every independent director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, give a declaration that he meets the criteria of independence.

What is Code for Independent Director?

Sub-section (8) of Section 149 provides that the independent directors shall abide by the provisions specified in Schedule IV. It is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfillment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.
It provides guidelines for professional conduct, roles, functions and duties, manner of appointments and reappointments, resignation/removal, separate meetings and evaluation mechanism.

**What is the Tenure of an Independent Director?**

The tenure of an independent director affects his independence. An independent director with "externality" may lose his independence or may become not so independent due to rapport established with the internal directors and the management. It is therefore necessary to limit the tenure of an independent director. Excessively long tenure of independent directors reflects: Closeness of the relationship between the independent director and management and lack of Board renewal.

As per proviso 10 to Section 149 of the Companies Act, 2013, subject to provisions of Section 152, an independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the company.

Provided that a person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only.

Provided further no independent director shall hold office for two consecutive terms but shall be eligible for appointment as independent director after the expiration of three years of ceasing to be an independent director in the company. (Section 149(11))

As per SEBI (LODR) Regulations the maximum tenure of independent directors shall be in accordance with the Companies Act, 2013 and rules made thereunder, in this regard, from time to time.

**Clarifications by MCA:**

1. Can independent directors appointed prior to April 1, 2014 continue and complete their remaining tenure, under the provisions of the Companies Act, 1956 or they should demit office and be re-appointed (should the company so decide) in accordance with the provisions of the new Act.

Explanation to section 149(11) clearly provides that any tenure of an independent director on the date of commencement of the Act shall not be counted for his appointment/ holding office of director under the Act. In view of the transitional period of one year provided under section 149(5), It has been clarified that it would be necessary that if it is intended to appoint existing independent directors under the new Act, such appointment shall be made expressly under section 149(10)/ (11) read with Schedule IV of the Act within one year from 1st April, 2014, subject to compliance with eligibility and other prescribed conditions.

2. Whether it would be possible to appoint an individual as an ID for a period less than five years.

It has been clarified that section 149(10) of the Act provides a term of "up to five consecutive years" for an Independent Director. As such while appointment of an 'ID' for a term of less than five years would be permissible, appointment for any term (whether for five years or less) is to be treated as a one term under section 149(10) of the Act. Further, under section 149(11) of the Act, no person can hold office of independent director for more than 'two consecutive terms'. Such a person shall have to demit office after two consecutive terms even if the total number of years of his appointment in such two consecutive terms is less than 10 years. In such a case the person completing 'consecutive terms of less than ten years' shall be eligible for appointment only after the expiry of the requisite cooling-off period of three years.
What are the provisions relating to remuneration of independent Directors?

Section 149(9) provides that notwithstanding anything contained in any other provision of this Act, but subject to the provisions of sections 197 and 198, an independent director shall not be entitled to any stock option and may receive remuneration by way of fee provided under sub-section (5) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.

How to evaluate Performance of an Independent director?

Section 178(2) read with Schedule IV: The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall carry out evaluation of every director’s performance. The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated. On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

What is the Legal position of an Independent Director?

Independent directors are invited to sit on the board purely on account of their special skills and expertise in particular fields and they represent the conscience of the investing public and also take care of public interest. Independent directors bear a fiduciary responsibility towards shareholders and the creditors. The company and the board are responsible for all the consequences of actions taken by the officers of the company.

As per Section 149(12), notwithstanding anything contained in this Act, an independent director; shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

Further, Section 149(13) states that the provisions of sections 152(6) & (7) in respect of retirement of directors by rotation shall not be applicable to appointment of independent directors.

Term of Office

An independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the company.

Provided that a person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only.

Provided further that an independent director, who completes his above mentioned term shall be eligible for appointment as independent director in the company only after the expiration of three years of ceasing to be an independent director in the company.

Limit on number of directorships

As per Regulation 25 of (LODR) Regulation,

a. A person shall not serve as an independent director in more than seven listed companies.

b. Further, any person who is serving as a whole time director in any listed company shall serve as
an independent director in not more than three listed companies.

**Formal letter of appointment to Independent Directors**

a. The company shall issue a formal letter of appointment to independent directors in the manner as provided in the Companies Act, 2013.

b. The letter of appointment along with the detailed profile of independent director shall be disclosed on the websites of the company.

**Performance evaluation of Independent Directors**

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

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

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

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

**Separate meetings of the Independent Directors**

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

b. The independent directors in the meeting shall, inter-alia:
   
   i. review the performance of non-independent directors and the Board as a whole;
   
   ii. review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
   
   iii. assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

**Familiarization Program for Independent Directors**

The listed entity shall familiarise the independent directors through various programmes about the listed entity, including the following:

a. nature of the industry in which the listed entity operates;

b. business model of the listed entity;

c. roles, rights, responsibilities of independent directors; and

d. any other relevant information.

**Liability of the Independent Director**

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

### 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 alongwith seven others accused. He was charged of attending only a few meetings in a year and took only macro view of the company’s developments. A non-vigilant act of non-executive chairman, accounted for death of thousands. “Ignorance” of the system by the director of the company is unacceptable. Role of non executive director in this case is questionable. Later he was granted bail.
7. Nominee Director

A nominee director belongs to the category of non-executive director and is appointed on behalf of an interested party.

It is pertinent to mention here that there is a divergent view as to whether a nominee director can be considered independent or not. Naresh Chandra Committee in its report stated that ‘nominee director’ will be excluded from the pool of directors in the determination of the number of independent directors. In other words, such a director will not feature either in the numerator or the denominator.

Both Listing Obligations and section 149(6) of the Companies Act, 2013 specifically exclude nominee director from being considered as Independent.

8. Lead Independent Director

Internationally, it is considered a good practice to designate an independent director as a lead independent director or senior independent director. He coordinates the activities of other non-employee directors and advises the chairman on issues ranging from the schedule of board meetings to recommending retention of advisors and consultants to the management.

- Acts as the principal liaison between the independent directors of the Board and the Chairman of the Board;
- Develops the agenda for and preside at executive sessions of the Board’s independent directors;
- Advises the Chairman of the Board as to an appropriate schedule for Board meetings, seeking to ensure that the independent directors can perform their duties responsibly while not interfering with the flow of Company operations;
- Approves with the Chairman of the Board the agenda for Board and Board Committee meetings and the need for special meetings of the Board;
- Advises the Chairman of the Board as to the quality, quantity and timeliness of the information submitted by the Company's management that is necessary or appropriate for the independent directors to effectively and responsibly perform their duties;
- Recommends to the Board the retention of advisors and consultants who report directly to the Board;
- Interviews, along with the chair of the Nominating and Corporate Governance Committee, all Board candidates, and make recommendations to the Nominating and Corporate Governance Committee;
- Assists the Board and Company officers in better ensuring compliance with and implementation of the Governance Guidelines;
- Serves as Chairman of the Board when the Chairman is not present; and
- Serves as a liaison for consultation and communication with shareholders.

California Public Employees’ Retirement System (CalPERS) provides that where the Chairman of the board is not an independent director, and the role of Chairman and CEO is not separate, the board should name a director as lead independent director who should have approval over information flow to
the board, meeting agendas, and meeting schedules to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors.

Other roles of the lead independent director should include chairing meetings of non-management directors and of independent directors, presiding over board meetings in the absence of the chair, serving as the principle liaison between the independent directors and the chair, and leading the board/director evaluation process. Given these additional responsibilities, the lead independent director is expected to devote a greater amount of time to board service than the other directors.

9. Chairman

The responsibility for ensuring that boards provide the leadership which is expected of them is that of their chairman. Chairmen, however, have no legal position; they are whoever the board elects to take the chair at a particular meeting. Boards are not bound to continue with the same chairman for successive meetings. In law, all directors have broadly equal responsibilities and chairmen are no more equal than any other board member. Chairmen are an administrative convenience and a means of ensuring that board meetings are properly conducted.

Thus from a statutory point of view there is no necessity for a board to have a continuing chairman. The chairmanship could, for example, rotate among board members. Although board chairmen have no statutory position, the choice of who is to fill that post is crucial to board effectiveness. If the chairman is not up to the task, it is improbable that the meeting will achieve anything but frustration and waste of that most precious of resources—time. Continuity and competence of chairmanship is vital to the contribution which boards make to their companies. The leaders which boards give to their companies, stems from the leadership which chairmen give to their boards.

The Chairman’s primary responsibility is for leading the Board and ensuring its effectiveness.

The role of the Chairman includes:

→ setting the Board agenda, ensuring that Directors receive accurate, timely and clear information to enable them to take sound decisions, ensuring that sufficient time is allowed for complex or contentious issues, and

→ encouraging active engagement by all members of the Board;

→ taking the lead in providing a comprehensive, formal and tailored induction programme for new Directors, and in addressing the development needs of individual Directors to ensure that they have the skills and knowledge to fulfill their role on the Board and on Board Committees;

→ evaluating annually the performance of each Board member in his/her role as a Director, and ensuring that the performance of the Board as a whole and its Committees is evaluated annually. Holding meetings with the non executive Directors without the executives being present;

→ ensuring effective communication with shareholders and in particular that the company maintains contact with its principal shareholders on matters relating to strategy, governance and Directors’ remuneration. Ensuring that the views of shareholders are communicated to the Board as a whole.

The main features of the role of chairman are as follows:

→ Being chairman of the board, he/she is expected to act as the company’s leading representative
which will involve the presentation of the company’s aims and policies to the outside world;

→ to take the chair at general meetings and at board meetings. With regard to the latter this will involve:

→ the determination of the order of the agenda;

→ ensuring that the board receives proper information;

→ keeping track of the contribution of individual directors and ensuring that they are all involved in discussions and decision making. At all meetings the chairman should direct discussions towards the emergence of a consensus view and sum up discussions so that everyone understands what has been agreed;

→ to take a leading role in determining the composition and structure of the board. This will involve regular reviews of the overall size of the board, the balance between executive and non-executive directors and the balance of age, experience and personality of the directors (diversity).

The chairman is responsible for leadership of the board, ensuring its effectiveness on all aspects of its role and setting its agenda. The chairman is also responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders. The chairman should also facilitate the effective contribution of non-executive directors in particular and ensure constructive relations between executive and non-executive directors.

First proviso to Section 203 of the Companies Act, 2013 provides for the separation of role of Chairman and Chief Executive Officer subject to conditions thereunder.

Regulation 17(1)(b) of SEBI (LODR) Regulations further provides that in case the Chairman of the board in a non-executive director, at least one-third of the Board should comprise independent directors and in case where the listed entity does not have a regular non-executive Chairman, at least half of the Board should comprise independent directors.

As per the Institute of Directors (IOD) (UK), the following are the responsibilities of a chairman

• The chairman's primary role is to ensure that the board is effective in its tasks of setting and implementing the company’s direction and strategy.

• The chairman is appointed by the board and the position may be full-time or part time. The role is often combined with that of managing director or chief executive in smaller companies. However, the joint role is considered to be less appropriate for public companies listed on the Stock Exchange.

10. Chief Executive Officer (CEO)

The Board appoints the CEO based on the criterion of his capability and competence to manage the company effectively. His main responsibilities include developing and implementing high-level strategies, making major corporate decisions, managing the overall operations and resources of a company, and acting as the main point of communication between the board of directors and the corporate operations. He is involved with every aspect of the company’s performance. The CEO is supported and advised by a skilled board and CEO is ultimately accountable to the board for his actions.
The most important skill of a CEO is to think strategically. His key role is leading the long term strategy and its implementation, it further includes:

→ Developing implementation plan of action to meet the competition and keeping in mind the long term existence of the company
→ Adequate control systems
→ Monitoring the operating and financial outcomes against the set plan
→ Remedial action
→ Keeping the Board informed

CEO should be able to, by the virtue of his ability, expertise, resources and authority keep the company prepared to avail the benefit of any change whether external or internal.

**Separation of role of Chairman and Chief Executive Officer**

It is perceived that separating the roles of chairman and chief executive officer (CEO) increases the effectiveness of a company’s board. This is also provided in the Section 203 of the Companies Act, 2013.

It is the board’s and chairman’s job to monitor and evaluate a company’s performance. A CEO, on the other hand, represents the management team. If the two roles are performed by the same person, then it’s an individual evaluating himself. When the roles are separate, a CEO is far more accountable.

A clear demarcation of the roles and responsibilities of the Chairman of the Board and that of the Managing Director/CEO promotes balance of power. The benefits of separation of roles of Chairman and CEO can be:

1. Director Communication: A separate chairman provides a more effective channel for the board to express its views on management
2. Guidance: A separate chairman can provide the CEO with guidance and feedback on his/her performance
3. Shareholders’ interest: The chairman can focus on shareholder interests, while the CEO manages the company
4. Governance: A separate chairman allows the board to more effectively fulfill its regulatory requirements
5. Long-Term Outlook: Separating the position allows the chairman to focus on the long-term strategy while the CEO focuses on short-term profitability
6. Succession Planning: A separate chairman can more effectively concentrate on corporate succession plans.

**11. Company Secretary**

As per Section 2(24) of the Companies Act, 2013, “company secretary” or “secretary” means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act;

Under Section 2(60) of the Companies Act, the company secretary has also been included in the category of the officer of the company and shall be considered to be in default in complying with any provisions of the Companies Act, 2013.
A Company Secretary, being a close confidante of the board will also be able to command confidence of individual directors so as to ensure that the culture of independence is promoted at the board and committee meetings and at the level of individual directors. Company Secretary:

- acts as a vital link between the company and its Board of Directors, shareholders and other stakeholders and regulatory authorities
- plays a key role in ensuring that the Board procedures are followed and regularly reviewed
- provides the Board with guidance as to its duties, responsibilities and powers under various laws, rules and regulations
- acts as a compliance officer as well as an in-house legal counsel to advise the Board and the functional departments of the company on various corporate, business, economic and tax laws
- is an important member of the corporate management team and acts as conscience keeper of the company

Section 2(51) of the Companies Act, 2013 defines KMP as

“Key managerial personnel”, in relation to a company, means —

(i) the Chief Executive Officer or the managing director or the manager;
(ii) the company secretary;
(iii) the whole-time director;
(iv) the Chief Financial Officer; and
(v) such other officer as may be prescribed.

In the light of provisions of Section 2(60) of Companies Act, 2013 Company Secretary is also an officer in default.

**Functions and Duties of a Company Secretary**

Section 205 of the Companies Act, 2013 prescribes that the functions of the company secretary shall include,—

(a) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;
(b) to ensure that the company complies with the applicable secretarial standards;
(c) to discharge such other duties as may be prescribed.

*Explanation*—For the purpose of this clause, the expression “secretarial standards” means secretarial standards issued by the Institute of Company Secretaries of India and approved by the Central Government.

Further, Rule 10 of the Companies (Appointment and Remuneration of managerial Personnel) Rules, 2014:-

- To guide the directors of the company regarding their duties, responsibilities and powers
- To facilitate the convening of meetings
- To attend Board Meetings, Committee Meetings and General Meetings
• To maintain minutes of the meetings
• To obtain the approvals from Board, General Meeting, Government and other authorities as required
• To represent before various regulators, and other authorities
• To assist the Board in the conduct of affairs of the company
• To assist and advise the Board in ensuring good corporate governance
• To assist and advise the Board in ensuring the compliance of corporate governance requirements and best practices
• To discharge such other duties as specified under the Act or rules
• To discharge such other duties as may be assigned by the Board from time to time

Appointment of Company Secretary

Section 203 (2) of Companies Act, 2013 provides that every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration. Rule 8 and 8A of companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014

Rule 8 – Every listed company and every public company having paid up capital of 10 crore or more rupees shall have whole-time Key Managerial personnel.

Rule 8A – Companies other than covered under rule 8 which has paid up capital of 5 crore or more shall have a whole-time Company Secretary.

The Financial Aspects of Corporate Governance 1992 (Cadbury Report) provides that the company secretary has a key role to play in ensuring that board procedures are both followed and regularly reviewed. The chairman and the board will look to the company secretary for guidance on what their responsibilities are under the rules and regulations to which they are subject and on how those responsibilities should be discharged. All directors should have access to the advice and services of the company secretary and should recognise that the chairman is entitled to the strong and positive support of the company secretary in ensuring the effective functioning of the board. It should be standard practice for the company secretary to administer, attend and prepare minutes of board proceedings.

UK Corporate Governance Code 2012 provides that the company secretary’s responsibilities include ensuring good information flows within the board and its committees and between senior management and non-executive directors, as well as facilitating induction and assisting with professional development as required. The company secretary should be responsible for advising the board through the chairman on all governance matters.

King Code of Corporate Governance for South Africa, 2009

Principle 1.22: The board should be assisted by a competent Company Secretary

→ The company secretary has a pivotal role to play in the corporate governance of a company, and it is advisable that entities other than companies delegate this responsibility to an appropriate individual(s) or organisation.

→ The chairman and board will look to the company secretary for guidance on their responsibilities
and their duties and how such responsibilities and duties should be properly discharged in the best interests of the company.

→ The company secretary should ensure that the board and board committee charters are kept up to date. The company secretary should have a direct channel of communication to the chairman and should be available to provide comprehensive practical support and guidance to directors, with particular emphasis on supporting the non-executive directors and the chairman.

→ The company secretary should provide a central source of guidance and advice to the board, and within the company, on matters of ethics and good governance, as well as providing administrative support to the board and board committees.

→ The company secretary is responsible to ensure the proper compilation of board papers.

→ The company secretary should be tasked with the obligation of eliciting appropriate responses, feedback and input to specific agenda items in board and board committee deliberations. The company secretary’s role should also be to raise matters that may warrant the attention of the board.

→ The company secretary must ensure that the minutes of board and board committee meetings are circulated to the directors in a timely manner, after the approval of the chairman of the relevant board committee.

→ The appointment and removal of a company secretary is a matter for the board.

→ The board should be cognizant of the duties imposed upon the company secretary and should empower the individual accordingly to enable him to properly fulfil those duties.

→ The company secretary should ensure that the procedure for the appointment of directors is properly carried out and he should assist in the proper induction, orientation and development of directors, including assessing the specific training needs of directors and executive management in their fiduciary and other responsibilities.

**Board Composition**

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. Section 149 of Companies Act 2013, provides following in relation to Board Composition:

(1) Every company shall have a Board of Directors consisting of individuals as directors and shall have—

(a) a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; and

(b) a maximum of fifteen directors:

Provided that a company may appoint more than fifteen directors after passing a special resolution:

Provided further that such class or classes of companies as may be prescribed, shall have at least one woman director.
(2) Every company existing on or before the date of commencement of this Act shall within one year from such commencement comply with the requirements of the provisions of sub-section (1).

(3) Every company shall have at least one director who has stayed in India for a total period of not less than one hundred and eighty-two days in the previous calendar year.

(4) Every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.

*Explanation.*—For the purposes of this sub-section, any fraction contained in such one-third number shall be rounded off as one.

(5) Every company existing on or before the date of commencement of this Act shall, within one year from such commencement or from the date of notification of the rules in this regard as may be applicable, comply with the requirements of the provisions of sub-section (4).

Further, as per Section 151 of the Companies Act, 2013, a listed company may have one director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed.

*Explanation*- For the purpose of this section “small shareholders” means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014 prescribes provisions related to appointment of small shareholders’ director

Regulation 17 of the SEBI (LODR) Regulations, mandates as under:

(i) The Board of Directors of the company shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty percent of the Board of Directors comprising non-executive directors.

(ii) Where the Chairperson of the Board is a non-executive director, at least one-third of the Board should comprise independent directors and in case the listed entity does not have a regular non-executive Chairman, at least half of the Board should comprise 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 Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.

*Explanation:* For the purpose of the expression “related to any promoter” referred to in sub-clause (2):

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.

An aspect of Board structure which is fundamental but is very less visited is that of the Board Size. Board size is also an important determinant of board effectiveness. The size should be large enough to secure sufficient expertise on the board, but not so large that productive discussion is impossible.
SEGMENT II

BOARD CHARTER

As a good practice companies may have a Board Charter which is intended as a tool to assist directors in fulfilling their responsibilities as Board members. It sets out the respective roles, responsibilities and authorities of the Board and of Management in the governance, management and control of the organization. This charter should be read in conjunction with the Company’s Memorandum and Articles.

A Model Charter may include the following:

The Role of the Board

The principal functions and responsibilities of the Board relating to

○ Strategies
○ Corporate Governance
○ Financial Management
○ Relationship with Senior Management

The Role of the Chairman

The Role of the CEO

The Role of the Company Secretary

Directors Code of Conduct

Conflicts of Interests

Related Party transactions

Board Members Qualifications, skills

Board Meetings

Delegation of Authority by the Board

○ Role & power of Committees
○ Committee Meetings

Protocol for media contact and comment

Hospitality and Gifts-- not solicit such courtesies and not accept gifts, services, benefits or hospitality that might influence, or appear to influence, the Directors’ conduct in representing the Company.

Board Evaluation

Directors liability insurance

Director Induction

Non-Executive Director Remuneration

Reimbursement of expenses

BOARD PROCESSES

It is important to consider elements of board processes that contribute to the effective & efficient performance of the Board.
Board Meetings

Decisions relating to the policy and operations of the company are arrived at meetings of the Board held periodically. Meetings of the Board enable discussions on matters placed before them and facilitate decision making based on collective judgment of the Board. This requires certain businesses to be approved at meetings of the Board only.

Good Practices in Convening Board Meetings

→ Annual Calendar

An Annual calendar that schedules the Board and committee meetings and accordingly dates by which action required is accomplished is an effective planner for the year. The planner schedules in advance the events so that both the providers of inputs and receivers of inputs can plan their work systematically.

→ Meeting Location

The board meetings should take place at a venue that is convenient to the directors (normally the head office). Boards are increasingly holding at least one board meeting at other company locations so that directors can see the other sites.

→ Board Meeting Frequency

Board meetings should be held regularly, at least four times in a year, with a maximum interval of 120 days between meetings.

As a rule of thumb and in line with best practice, six to ten meetings are likely to constitute an appropriate number of board meetings per year, particularly when committees meet between board sessions.

→ Board Agenda

Preparation of Agenda

The board agenda determines the issues to be discussed. The items for agenda should be collected from heads of all the departments. Secretary may segregate the ones that can be discussed and decided internally and the ones which need to be put up before the Board, in consultation with the Chairman and/or Managing Director and inputs from the CEO.

Any director can request that the chairman include a matter on the board agenda. It is the chairman’s prerogative to offer directors the opportunity to suggest items, which cannot be reasonably denied. In the end, it is each director’s responsibility to ensure that the right matters are tabled.

Key success factors for setting the agenda include:

- Agendas should strike a balance between reviews of past performance and forward-looking issues.
- Strategic issues require more time for debate so it is a good practice that the allocated discussion time is indicated in the agenda.
- Some issues will need to be brought to the board several times as projects progress and circumstances develop.

Factors to keep in mind

- Care should be taken not to consume too much board time on routine or administrative matters.
The agenda should show the amount of time allocated for each item, without unduly restricting discussion.

**Circulation of Notice & Agenda**

**Notice**

Even if meetings have been scheduled in advance, the members of the Board should be adequately and timely sent notice to enable them to plan accordingly. The Companies Act, 2013 as well as the Secretarial Standards provides that the notice of Board Meeting shall be sent at least 7 days before the meeting.

**Agenda**

The agenda should be made available to the Board along with supporting papers at least seven days in advance of the date of the meeting. The mode of circulation of agenda should ensure that all directors receive the agenda notes on time. All the material information should be sent to all Directors simultaneously and in a timely manner to enable them to prepare for the Board Meeting. This would enable the board and especially to non-executive and independent directors to prepare for the discussions based on the papers.

A system should exist for seeking and obtaining further information and clarifications on the agenda items before the meeting. Directors, including nominee directors, requiring any clarification before the meeting may be asked to contact the Secretary for additional inputs.

**Board Briefing Papers**

Board materials should be summarized and formatted so that board members can readily grasp and focus on the most significant issues in preparation for the board meeting. It is not necessary that more information means better quality. If relevant and complete information is presented in an orderly manner will be more useful than a bulky set of documents which has been put together without any order.

The Papers for Board meetings should be:

- **Short.** Board papers associated with a particular agenda item should be set out as an executive summary with further detail provided in annexures.
- **Timely.** Information should be distributed at least seven business days before the meeting.
- **Focused and action-oriented.** The papers should present the issue for discussion, offer solutions for how to effectively address the issue, and provide management’s view on which action to take.

If a proposal is more complex or requires additional explanation, the board should consider delegating the matter to a board committee or seek a detailed discussion or require an appraisal by an outside independent expert.

Directors should inform the chairman if the information they receive is insufficient for making sound decisions and monitoring responsibilities effectively.

**The Information Requirements for Board Meetings**

These requirements will vary among companies. In general, directors should expect to receive the following regular items at least seven days before the board meeting:

1. An agenda.
2. Minutes from last meeting along with action taken report.

3. Minutes of Committee Meetings.

4. Information of the statutory compliances of the laws applicable to the company.

Papers relating to specific agenda items. The reports should be clearly structured with headings such as: “Purpose,” “Background,” “Issues,” “Impact,” and “Recommendations”. Whenever possible, the report’s writer should list his/ her name as author with responsibilities for its contents, the date, and contact details.

Provisions Regarding Meetings of the Board

Meetings of the Board: Section 173 of Companies Act, 2013

Section 173 of the Act deals with Meetings of the Board

1. The Act provides that the first Board meeting should be held within thirty days of the date of incorporation.

2. In addition to the first meeting to be held within thirty days of the date of incorporation, there shall be minimum of four Board meetings every year and not more one hundred and twenty days shall intervene between two consecutive Board meetings.

3. In case of One Person Company (OPC), small company and dormant company, at least one Board meeting should be conducted in each half of the calendar year and the gap between two meetings should not be less than Ninety days.

Notice of Board Meetings

The Act as well as Secretarial Standard-I requires that not less than seven days’ notice in writing shall be given to every director at the registered address as available with the company. The notice can be given by hand delivery or by post or by electronic means.

In case the Board meeting is called at shorter notice, at least one independent director shall be present at the meeting. If he is not present, then decision of the meeting shall be circulated to all directors and it shall be final only after ratification of decision by at least one Independent Director.

Quorum for Board Meetings: Section 174

The act as well as Secretarial Standards provides that one third of total strength or two directors, whichever is higher, shall be the quorum for a meeting. If due to resignations or removal of director(s), the number of directors of the company is reduced below the quorum as fixed by the Articles of Association of the company, then, the continuing Directors may act for the purpose of increasing the number of Directors to that required for the quorum or for summoning a general meeting of the Company. It shall not act for any other purpose.

For the purpose of determining the quorum, the participation by a director through Video Conferencing or other audio visual means shall also be counted. If at any time the number of interested directors exceeds or is equal to two-thirds of the total strength of the Board of directors, the number of directors who are not interested and present at the meeting, being not less than two shall be the quorum during such time.

The meeting shall be adjourned due to want of quorum, unless the articles provide shall be held to the same day at the same time and place in the next week or if the day is National Holiday, the next working day at the same time and place.
Requirements and Procedures for Convening and Conducting Board’s Meetings

Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides for the requirements and procedures, in addition to the procedures required for Board meetings in person, for convening and conducting Board meetings through video conferencing or other audio visual means:

(1) Every Company shall make necessary arrangements to avoid failure of video or audio visual connection.

(2) The Chairperson of the meeting and the company secretary, if any, shall take due and reasonable care:
(a) to safeguard the integrity of the meeting by ensuring sufficient security and identification procedures;
(b) to ensure the availability of proper video conferencing or other audio visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorized participants at the Board meeting;
(c) to record the proceedings and prepare the minutes of the meeting;
(d) to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit of that particular year;
(e) to ensure that no person other than the concerned director are attending or have access to the proceedings of the meeting through video conferencing mode or other audio visual means; and
(f) to ensure that participants attending the meeting through audio visual means are able to hear and see the other participants clearly during the course of the meeting, but the differently abled persons, may make request to the Board to allow a person to accompany him.

(3) (a) The notices of the meeting shall be sent to all the directors in accordance with the provisions of sub-section (3) of section 173 of the Act.
(b) The notice of the meeting shall inform the directors regarding the option available to them to participate through video conferencing mode or other audio visual means, and shall provide all the necessary information to enable the directors to participate through video conferencing mode or other audio visual means.
(c) A director intending to participate through video conferencing mode or audio visual means shall communicate his intention to the Chairman or the company secretary of the company.
(d) If the director intends to participate through video conferencing or other audio visual means, he shall give prior intimation to that effect sufficiently in advance so that company is able to make suitable arrangement in this behalf.
(e) The director, who desire, to participate may intimate his intention of participation through the electronic mode at the beginning of the calendar year and such declaration shall be valid for one calendar year.
(f) In the absence of any such intimation from the director, it shall be assumed that the director will attend the meeting in person.

(4) At the commencement of the meeting, a roll call shall be taken by the Chairperson when every director participating through video conferencing or other audio visual means shall state, for the
(a) name;
(b) the location from where he is participating;
(c) that he can completely and clearly see, hear and communicate with the other participants;
(d) that he has received the agenda and all the relevant material for the meeting; and
(e) that no one other than the concerned director is attending or having access to the proceedings of the meeting at the location mentioned in (b) above.

(5) (a) After the roll call, the Chairperson or the Secretary shall inform the Board about the names of persons other than the directors who are present for the said meeting at the request or with the permission of the Chairman and confirm that the required quorum is complete.

Explanation: It is clarified that a director participating in a meeting through video conferencing or other audio visual means shall be counted for the purpose of quorum, unless he is to be excluded for any items of business under any provisions of the Act or the Rules.

(b) The roll call shall also be made at the conclusion of the meeting and at the re-commencement of the meeting after every break to confirm the presence of a quorum throughout the meeting.

(6) With respect to every meeting conducted through video conferencing or other audio visual means authorised under these rules, the scheduled venue of the meeting as set forth in the notice convening the meeting, which shall be in India, shall be deemed to be the place of the said meeting and all recordings of the proceedings at the meeting shall be deemed to be made at such place.

(7) The statutory registers which are required to be placed in the Board meeting as per the provisions of the Act shall be placed at the scheduled venue of the meeting and where such registers are required to be signed by the directors, the same shall be deemed to have been signed by the directors participating through electronic mode if they have given their consent to this effect and it is so recorded in the minutes of the meeting.

(8) (a) Every participant shall identify himself for the record before speaking on any item of business on the agenda.

(b) If a statement of a director in the meeting through video conferencing or other audio visual means is interrupted or garbled, the Chairperson or company secretary shall request for a repeat or reiteration by the director.

(9) If a motion is objected to and there is a need to put it to vote, the Chairperson shall call the roll and note the vote of each director who shall identify himself while casting his vote.

(10) From the commencement of the meeting until the conclusion of such meeting, no person other than the Chairperson, directors, Secretary and any other person whose presence is required by the Board shall be allowed access to the place where any director is attending the meeting either physically or through video conferencing without the permission of the Board.

(11) (a) At the end of discussion on each agenda item, the Chairperson of the meeting shall announce the summary of the decision taken on such item along with names of the directors, if any, dissented from the decision taken by majority.
(b) The minutes shall disclose the particulars of the directors who attended the meeting through video conferencing or other audio visual means.

(12) (a) The draft minutes of the meeting shall be circulated among all the directors within fifteen days of the meeting either in writing or in electronic mode as may be decided by the Board.

(b) Every director who attended the meeting, whether personally or through video conferencing or other audio visual means, shall confirm or give his comments, about the accuracy of recording of the proceedings of that particular meeting in the draft minutes, within seven days or some reasonable time as decided by the Board, after receipt of the draft minutes failing which his approval shall be presumed.

(c) After completion of the meeting, the minutes shall be entered in the minute book as specified under section 118 of the Act and signed by the Chairperson.

Explanation - For the purposes of this rule, ‘video conferencing or other audio visual means’ means audio-visual electronic communication facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

Matters not to be dealt with in a Meeting through Video Conferencing or other Audio Visual Means

Rule 4 prescribe restriction on following matters which shall not be dealt with in any meeting held through video conferencing or other audio visual means:

(i) the approval of the annual financial statements;

(ii) the approval of the Board’s report;

(iii) the approval of the prospectus;

(iv) the Audit Committee Meetings for consideration of financial statements including consolidated financial statements to be approved by the Board.

(v) the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

Penalty

Every officer of the company who is duty bound to give notice under this section if fails to do so shall be liable to a penalty of twenty five thousand rupees.

Compliance with Secretarial Standards relating to Board Meetings

For the first time in the history of Company Law in India, the Companies Act, 2013 has given statutory recognition to the Secretarial Standards issued by the Institute of Company Secretaries of India.

Section 118(10) of the Act reads as under:

Every company shall observe secretarial standards with respect to general and Board meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government.

In the context of this provision, observance of Secretarial Standards issued by the Institute of Company Secretaries of India (ICSI) assumes special relevance and companies will have to ensure that there is compliance with these standards on their part.

The ICSI has notified SS1 and SS2 on meetings of the board of directors and general meetings respectively. These are effective 1 July 2015.
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Decision Making Process at the Meeting

(I) The Chairman and/or Managing Director should explain the proposal put up before the Board, the background and the expectation of the proposal in the short as well as the long-term to contribute to the growth of the company. If need be, a presentation may be made by the executive concerned for easing the considerations and discussions of the Board as they tend to highlight the key elements within the written data.

(II) The criticality and viability of the proposal should be explained and their views should be elicited from all angles.

(III) The Board could then deliberate all these issues and come to a decision.

Voting

Voting practices at board meetings differ worldwide. In some countries, it is usual for a majority vote to signify board approval. In this situation, decisions are made quickly and minority dissent is accepted. However, many corporate governance experts argue that boards should be collegial; consensus must be attained on every agenda item without the need to take a vote. In this case, the chairman will often require skill in obtaining unanimity among the directors — even though the debate initially may have involved substantial constructive dissent.

Minutes of the Meeting

Section 118 provides that every company shall prepare, sign and keep minutes of proceedings of every general meeting, including the meeting called by the requisitionists and all proceedings of meeting of any class of share holders or creditors or Board of Directors or committee of the Board and also resolution passed by postal ballot within thirty days of the conclusion of every such meeting concerned. In case of meeting of Board of Directors or of a committee of Board, the minutes shall contain name of the directors present and also name of dissenting director or a director who has not concurred the resolution. The chairman shall exercise his absolute discretion in respect of inclusion or non-inclusion of the matters which is regarded as defamatory of any person, irrelevant or detrimental to company’s interest in the minutes.

Minutes kept shall be evidence of the proceedings recorded in a meeting.

Rule 25 of the Companies (Management and Administration) Rules, 2014 contains provisions with regards to minutes of meetings.

A distinct minute book shall be maintained for each type of meeting namely:

(i) general meetings of the members;
(ii) meetings of the creditors;
(iii) meetings of the Board; and
(iv) meetings of the committees of the Board.

It may be noted that resolutions passed by postal ballot shall be recorded in the minute book of general meetings as if it has been deemed to be passed in the general meeting. In no case the minutes of proceedings of a meeting or a resolution passed by postal ballot shall be pasted to any such book.

In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer’s report shall
be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution.

Minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting. Each page of every such book shall be initialed or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed by:

- in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;
- in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose;
- in case of every resolution passed by postal ballot, by the chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

Minutes books shall be preserved permanently and kept in the custody of the company secretary of the company or any director duly authorized by the Board for the purpose and shall be kept in the registered office or such place as the members may decide by passing special resolution pursuant to requirement of section 88 read with section 94 of the Act.

**Adequacy of Minutes**

Minutes are the written record of a board or committee meeting. Preparation of minutes of general, Board and committee meetings is a legal requirement under section 118 of Companies Act, 2013. The Company secretary should ensure compliance of the same accordingly. At a minimum, the minutes must contain:

- Meeting location and date
- Names of attendees and absentees
- Principal points arising during discussion
- Board decisions

Minutes record what actually happens at a meeting in the order in which it happened, regardless of whether the meeting followed the written agenda. The minutes are important legal documents and, by law, must be kept by the company. They also serve as important reminders of action to be taken between meetings.

Minutes should strike a balance between being a bare record of decisions and a full account of discussions. On more routine housekeeping matters or more sensitive personnel issues, a brief record is appropriate. For most items, there should be a summary of the matter discussed and the issues considered. The final decision must be recorded clearly and concisely. That amount of attention is desirable to show that the board has acted with due care and complied with any legal duties and obligations.

Where a director disagrees with a board decision, he may ask to have their disagreement recorded in the minutes. This could be important to avoid future liability for any decision that involves a breach of law or misuse of the board’s powers.

It is the chairman’s responsibility to ensure that sufficient time is allowed for discussion of complex or contentious issues. It is a good practice to draft the minutes of the meetings and circulate them to the directors in reasonable time, perhaps not later than a week.
Confidentiality

All board papers and proceedings should be considered to be highly confidential. Board papers should not be shown or circulated to non-directors. Directors should take great care not to discuss or disclose any board meeting content or proceedings outside the boardroom.

As per SS-1

- Minutes shall be recorded in books maintained for that purpose.
- A distinct Minutes Book shall be maintained for Meetings of the Board and each of its Committees.
- Minutes may be maintained in electronic form in such manner as prescribed under the Act and as may be decided by the Board. Minutes in electronic form shall be maintained with Timestamp.
- The pages of the Minutes Books shall be consecutively numbered.
- Minutes shall not be pasted or attached to the Minutes Book, or tampered with in any manner.
- Minutes of the Board Meetings, 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 of the Board Meeting shall be kept at the Registered Office of the company or at such other place as may be approved by the Board.
- Minutes shall contain a fair and correct summary of the proceedings of the Meeting.
- Minutes shall be written in clear, concise and plain language.
- Any document, report or notes placed before the Board and referred to in the Minutes shall be identified by initialling of such document, report or notes by the Company Secretary or the Chairman.
- Where any earlier Resolution (s) or decision is superseded or modified, Minutes shall contain a reference to such earlier Resolution (s) or decision.
- Minutes of the preceding Meeting shall be noted at a Meeting of the Board held immediately following the date of entry of such Minutes in the Minutes Book.
- Within fifteen days from the date of the conclusion of the Meeting of the Board or the Committee, the draft Minutes thereof shall be circulated by hand or by speed post or by registered post or by courier or by e-mail or by any other recognised electronic means to all the members of the Board or the Committee for their comments.
- Minutes shall be entered in the Minutes Book within thirty days from the date of conclusion of the Meeting.
- The date of entry of the Minutes in the Minutes Book shall be recorded by the Company Secretary.
- Minutes, once entered in the Minutes Book, shall not be altered. Any alteration in the Minutes as entered shall be made only by way of express approval of the Board at its subsequent Meeting in which such Minutes are sought to be altered.
- 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.

A copy of the 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 Directors within fifteen days after these are signed.

The Minutes of Meetings of the Board and any Committee thereof can be inspected by the Directors.

Extracts of the Minutes shall be given only after the Minutes have been duly entered in the Minutes Book. However, certified copies of any Resolution passed at a Meeting may be issued even earlier, if the text of that Resolution had been placed at the Meeting.

Minutes of all Meetings shall be preserved permanently in physical or in electronic form with Timestamp.

Office copies of Notices, Agenda, Notes on Agenda and other related papers shall be preserved in good order in physical or in electronic form for as long as they remain current or for eight financial years, whichever is later and may be destroyed thereafter with the approval of the Board.

Minutes Books shall be kept in the custody of the Company Secretary.

Separate Meetings

Boards shall consider organizing separate meetings with independent directors to update them on all business-related issues and new initiatives. These meetings give an opportunity for independent directors for exchanging valuable views on the issues to be raised at the Board meetings. Such meetings are chaired by the senior/lead independent director. The outcome of the meeting is put forward at the Board meeting.

Schedule IV of the Companies Act, 2013 provides following regarding separate meeting of the Independent Directors:

1. The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management;

2. All the independent directors of the company shall strive to be present at such meeting;

3. The meeting shall:
   a. review the performance of non-independent directors and the Board as a whole;
   b. review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
   c. assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

Further, SEBI (LODR) Regulations also mandates the separate meeting of independent directors for all the listed companies. The provisions given in the companies Act and that in the SEBI (LODR) Regulations regarding separate meeting are same.
Directors’ Time Commitment

Directors typically should allocate at least as much time for preparation as for the board meeting itself. With strategy retreats or “away days,” travel, reading, meeting preparation time, and attendance at ad hoc and committee meetings, directors usually spend three or four days per month for a single, non-executive director position.

The time spent to prepare for audit committee meetings is normally longer than that for most other board meetings.

Should the time commitment of directors become an issue, then companies may wish to limit the number of external appointments that directors can hold.

Directors should always evaluate the demands on their time before allowing themselves to be considered for an appointment. Directors should disclose any other board or external appointment to the nomination committee before their appointment, and regularly update the board after appointment.

Powers of the Board

In terms Section 179 of the Companies Act, 2013 the Board of directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do. The Board shall not exercise any power or do any act or thing which is required, whether by this or any other Act or by the memorandum or articles of the company, to be exercised or done by the company in general meeting.

As per Section 179(3) read with Rule 8 of Companies (Meetings of Board and its Powers) Rules, 2014, the Board of Directors of a company shall exercise the following powers on behalf of the company by means of resolutions passed at meetings of the Board, namely:

1. to make calls on shareholders in respect of money unpaid on their shares;
2. to authorise buy-back of securities under section 68;
3. to issue securities, including debentures, whether in or outside India;
4. to borrow monies;
5. to invest the funds of the company;
6. to grant loans or give guarantee or provide security in respect of loans;
7. to approve financial statement and the Board’s report;
8. to diversify the business of the company;
9. to approve amalgamation, merger or reconstruction;
10. to take over a company or acquire a controlling or substantial stake in another company;
11. to make political contributions;
12. to appoint or remove key managerial personnel (KMP);
13. to take note of appointment(s) or removal(s) of one level below the Key Management Personnel;
14. to appoint internal auditors and secretarial auditor;
15. to take note of the disclosure of director’s interest and shareholding;
(16) to buy, sell investments held by the company (other than trade investments), constituting five percent or more of the paid–up share capital and free reserves of the investee company;

(17) to invite or accept or renew public deposits and related matters;

(18) to review or change the terms and conditions of public deposit;

(19) to approve quarterly, half yearly and annual financial statements or financial results as the case may be.

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. The company may impose restriction and conditions on the powers of the Board.

Section 180 imposes restrictions on the powers of the Board. It provides that the board can exercise the following powers only with the consent of the company by special resolution:–

(a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings;

(b) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;

(c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company’s bankers in the ordinary course of business;

(d) to remit, or give time for the repayment of, any debt due from a director.

The special resolution relating to borrowing money exceeding paid up capital and free reserves specify the total amount up to which the money may be borrowed by Board. The title of buyer or the person who takes on lease any property, investment or undertaking on good faith cannot be affected and also in case if such sale or lease covered in the ordinary business of such company. The special resolution may also stipulate the conditions, including conditions regarding the use, disposal, investment of the sale proceeds, which may result from such transactions but this doesn’t authorise the company to reduce its capital except the provisions contained in this Act.

The debt incurred by the company exceeding the paid up capital and free reserves is not valid and effectual, unless the lender proves that the loan was advanced on good faith and without knowledge that the limit imposed had been exceeded.

SEGMENT III

RESPONSIBILITIES OF BOARD

Responsibilities cast upon Directors are quite onerous and multifarious. The duties of directors are partly statutory, partly regulatory and partly fiduciary. Directors are in a fiduciary position and must exercise their powers for the benefit of the company. Board is responsible for direction, control, conduct management and supervision of the company’s affairs. They have to establish effective corporate governance procedures and best practices and whistle blower mechanism. Ultimate control and management of the
company vests with the Board. The board functions on the principle of majority or unanimity. A decision is taken on record if it is accepted by the majority or all of the directors. A single director cannot take a decision. This is one of the purposes of forming a board. If the power of decision making is given to a single director he might take biased decisions. He may take decisions which benefit him in his personal capacity. The scope of bias, partiality and favouritisms is eliminated with the concept of the board.

The purpose of having a board in a company is:

- To contribute to the business of the company through their knowledge and skills.
- To advise on such matters as need their attention and influence.
- To critically analyze the performance and operations of the company.
- To be able to act as a professional aide.
- To be able to offer their professional expertise in the relevant field.
- To establish sound business principles and ethics.
- To act as a mentor to the management.

The responsibilities of the directors can be summarized as below:

**Responsibilities towards the company**

The board should ensure that:

- It acts in the best interest of the company.
- The decisions it takes do not serve the personal interests of its members.
- It helps the company in increasing its profits and turnover by following principles of equity, ethics and values.
- It helps the company in building its goodwill.
- It shares with the management the decision taken by them and the reasons thereof.
- That the company has systems and means to best utilize the resources of the company and especially its intangible resources.

**Responsibilities towards management**

The board must ensure that:

- It gives its guidance, support and direction to the management in every decision.
- It acts as leader to inspire and motivate the management to perform their duties.
- It encourages compliance and disclosures.
- It trusts the management and gives it the freedom to act.
- It does not dictate terms but take objective decisions.
- It follows the company’s code of conduct and the other rules and the regulations of the company.

**Responsibilities towards stakeholders**

The board must ensure that:

- Its every decision helps in the increasing the stakeholders value.
- It does not act in a manner by which any stakeholder is prejudiced.
• One stakeholder should not be benefited at the cost of the other. — It must discourage restrictive or monopolistic activities for the undue benefit of the company.

• That proper system is established and followed which helps in resolving the grievances of the stakeholders.

• the company has policies for different class of stakeholders which are equally applicable. Such policies should be based on the principles of equity and justice.

• the company discloses its policies to all the stakeholders.

• The stakeholders are able to establish long term relationships based on trust and confidence.

Corporate Social Responsibility

The board must ensure that:

• The company has policies which encourage social activities on purely non profitable basis.

• Such policies are followed ethically and resources are provided to give effect to these policies.

• The actual benefit is actually passed on to the society by doing such activities.

• That these policies cover activities such as upliftment of society, providing education to the needy, promoting employment, preservation of environment, etc.

• That the company’s products are eco-friendly and comply with all the related norms.

• That the company does not take any decision which affects the society adversely.

Responsibility towards government

The board must ensure that:

• The company complies with all the laws applicable to it whether they are the central laws or state laws.

• There are systems and checks to ensure that the above is complied.

• That all the dues towards the government in the form of taxes, rates, etc. are paid on time.

• It supports the initiatives taken by the government for the promotion of welfare and security of the nation.

Inter-se responsibilities

The board must ensure that:

• True and full disclosure of all the transactions, where there is an interest, is made to the other members of the board.

• It follows board decorum and code for conduct of meetings.

• All relevant information is shared among themselves for a proper decision making.

• It is able to take independent, unbiased and objective decisions.

• The executive directors respect and give due regard to the presence and opinions of the non-executive independent directors.
RESPONSIBILITY FOR LEADERSHIP

According to Adrian Cadbury, if the company has to make the most of its opportunities, the Board has to be a source of inspiration for the goals it sets. The Board is responsible for the manner in which a company achieves its goals and therefore for the kind of enterprise it is and that which it aspires to become.

The effectiveness of the board depends largely on the leadership skills, capabilities and commitment to corporate governance practices of each individual director. The responsibility of the board is also to provide leadership in advancing the company's vision, values and guiding principles. The board is collectively responsible for promoting the success of the company by directing and supervising the company's affairs. The board's role is to provide entrepreneurial leadership within a framework of prudent and effective controls, which enable risk to be assessed and managed. The board sets the company's strategic aims, ensures that the necessary financial, human resources & infrastructure are in place for the Company to meet its objectives and review management performance.

Policy Governance

Policy Governance, an integrated board leadership paradigm created by Dr. John Carver, is a groundbreaking model of governance designed to empower boards of directors to fulfill their obligation of accountability for the organizations they govern. As a generic system, it is applicable to the governing body of any enterprise. The model enables the board to focus on the larger issues, to delegate with clarity, to control management's job without meddling, to rigorously evaluate the accomplishment of the organization; to truly lead its organization.

Policy Governance framework is designed to enable intelligent, well-intended board members to govern as well as to perform as far as possible. It “channels the wisdom of board members, links them and their work to important constituencies, focuses them on the large long term issues, and makes possible the optimal empowerment and fair judgment of management”.

The popular belief is that board is not a mere overseer of management actions; nor is it an approver. It is a locus of decision making in the owner-to-operator sequence of authority. Contrary to being an approver, it is a generator, an active link in the chain of command.

“Boards should make policy, boards should deal with vision and the long term, boards should avoid trivia, boards should not meddle and micromanage; all board members should come prepared and be participative, and so forth. These exhortations may be good ones, but they are elementary in the extreme—more fitting for Polonius than for a theorist. At any rate, it is embarrassing that they are the level addressed by many of the efforts to improve modern governance. Policy governance goes much, much further.”

Policy Governance defines policy to include all possible pronouncements within a carefully crafted arrangement encompassing all board policies.

“It is the single, central repository of written board wisdom, rather than one of several board products. Replacing reams of previous board documents, these documents often number fewer than fifty pages—board members can actually master all of them, using them as working documents and making frequent amendments. Moreover, board policies are truly the board’s policies, having been generated from board deliberation, not parroted from management recommendations. Explicit, comprehensive governing values of the organization enable new board members to find quickly what the board stands for. The chairperson and CEO have an unambiguous source for knowing board expectations of their roles”.

According to Adrian Cadbury, if the company has to make the most of its opportunities, the Board has to be a source of inspiration for the goals it sets. The Board is responsible for the manner in which a company achieves its goals and therefore for the kind of enterprise it is and that which it aspires to become.
Policy Governance separates issues of organizational purpose (ENDS) from all other organizational issues (MEANS), placing primary importance on those Ends. Policy Governance boards demand accomplishment of purpose, and only limit the staff's available means to those which do not violate the board's pre-stated standards of prudence and ethics.

The board's own Means are defined in accordance with the roles of the board, its members, the chair and other officers, and any committees the board may need to help it accomplish its job. This includes the necessity to “speak with one voice”. Dissent is expressed during the discussion preceding a vote. Once taken, the board's decisions may subsequently be changed, but are never to be undermined. The board's expectations for itself also set out self-imposed rules regarding the delegation of authority to the staff and the method by which board-stated criteria will be used for evaluation. Policy Governance boards delegate with care. There is no confusion about who is responsible to the board or for what board expectations they are responsible. Furthermore, boards that decide to utilize a CEO function are able to hold this one position exclusively accountable.

RELATIONSHIP BETWEEN DIRECTORS AND EXECUTIVE

Board and executive leadership need to work together based on mutual respect, trust and commitment. A board provides counsel to management and should not get involved in the day-to-day affairs of the organization. Clear expectations for the board and the director need to be established and maintained, because a board that is overly active in management can inhibit the organization's effectiveness. The Executive Management can help the board govern more and manage less by adopting the following three methods:

→ Use a comprehensive strategic plan that has been developed in conjunction with the board, and supplement it with regular progress reports. This will keep the board's sights focused on the long term goals and mission of the organization. Regular reports will keep board members apprised of progress toward organizational goals, and provide part of the basis for evaluation of the executive management.

→ Provide the board with relevant materials before board meetings, and explain why the materials are coming to the attention of the board. Let board members know how specific agenda items relate to the organization's larger mission, and what kind of action or discussion is desired of the board on each item.

→ Facilitate board and board committee discussions so that the board stays focused on the larger issues. Refer to set policies that define the limits of the board's decision-making power, and strive to engage the board in a dialogue among themselves that leads to consensus-building.

THE KEY DIFFERENCE BETWEEN DIRECTORS AND MANAGERS

There are many fundamental differences between being a director and a manager. The differences are numerous, substantial and quite onerous. The table below gives a detailed breakdown of the major differences between directing and managing:

<table>
<thead>
<tr>
<th>Basis</th>
<th>Directors</th>
<th>Managers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leadership</td>
<td>It is the board of directors who must provide the intrinsic leadership and direction at the top of the organization.</td>
<td>It is the role of managers to carry through the strategy on behalf of the directors.</td>
</tr>
<tr>
<td><strong>Decision Making</strong></td>
<td>Directors are required to determine the future of the organization and protect its assets and reputation. They also need to consider how their decisions related to ‘Stake-holders’ and the regulatory framework.</td>
<td>Managers are concerned with implementing the decisions and the policies made by the board.</td>
</tr>
<tr>
<td><strong>Duties and responsibilities</strong></td>
<td>Directors, not managers, have the ultimate responsibility for the long-term prosperity of the company. Directors are required in law to apply skill and care in exercising their duty to the company and are subject to fiduciary duties. If they are in breach of their duties or act improperly directors may be made personally liable in both civil and criminal law. On occasions, directors can be held responsible for acts of the company. Directors also owe certain duties to the stakeholders of the company.</td>
<td>Managers have far fewer legal responsibilities.</td>
</tr>
<tr>
<td><strong>Relationship with shareholders</strong></td>
<td>Directors are accountable to the shareholders for the company’s performance and can be removed from office by them or the shareholders can pass a special resolution requiring the Directors to act in a particular way. Directors act as “Fiduciaries” of the shareholders and should act in their best interests by also taking into account the best interests of the company (as a separate legal entity) and the other stakeholders.</td>
<td>Managers are usually appointed and dismissed by directors or management and do not have any legal requirement to be held to account.</td>
</tr>
<tr>
<td><strong>Ethics and values</strong></td>
<td>Directors have a key role in the determination of the values and ethical position of the company.</td>
<td>Managers must enact the ethos, taking their direction from the board.</td>
</tr>
<tr>
<td><strong>Company Administration</strong></td>
<td>Directors are responsible for the company’s administration.</td>
<td>While the related duties associated with company administration can be delegated to managers, the ultimate responsibility for them resides with the directors.</td>
</tr>
<tr>
<td><strong>Statutory Provisions on insolvency</strong></td>
<td>If a company becomes insolvent, law imposes various duties and responsibilities on directors that may involve personal liability, criminal prosecution and disqualification.</td>
<td>These statutory provisions do not affect managers.</td>
</tr>
<tr>
<td><strong>Statutory Provisions in</strong></td>
<td>There are many other statutory provisions that can create offences on strict liability under</td>
<td>Generally managers are not responsible under the Statutory</td>
</tr>
</tbody>
</table>
Barriers to Visionary Leadership

Frank Martinelli - Lists the barriers with a view to helping companies identify them in their organizations and to remove them to facilitate visionary board leadership:

► **Lack of Time Management** - Lack of time to attend meetings, read materials and maintain contact with each other in between meetings. The board members need to organize themselves for maximum effectiveness and avoid wasting time on trivial matters.

► **Resistance to risk taking** - In order to be innovative and creative in its decision-making, boards must be willing to take chances, to try new things, to take risks. Success in new ventures is never to be taken for granted. Boards need to acknowledge the tension points and discuss them with funders and other key supporters. Board leadership must strike a balance between taking chances and maintaining the traditional stewardship role.

► **Lack of Strategic Planning** - Strategic planning offers boards an opportunity to think about changes and trends that will have significant impact and develop strategies to respond to challenges. Some boards are not involved in strategic planning at all; others are involved in a superficial way. Therefore, the boards lose an important opportunity to hone/exercise visionary leadership skills.

► **Complexity** - Board members frequently lack a deep understanding of critical changes, trends and developments that challenge fundamental assumptions about how it defines its work and what success looks like. This lack of knowledge results in a lack of confidence on the part of the board to act decisively and authoritatively.

► **Micro Management** - It is necessary that the board focuses its attention on items of critical importance to the organization. If the board is tempted to micro manage or to meddle in lesser matters, an opportunity to provide visionary leadership is lost.

► **Clinging to Tradition** – Boards often resist change in order to preserve tradition. However, changing environment requires the Boards to be open to change. Maira and Scott - Morgan in “The Accelerating Organisation” point out that continuous shedding of operating rules is necessary because of changing environmental conditions. But shedding becomes more complicated in systems involving human beings, because their sense of self-worth is attached to many old rules. This human tendency to hold on to the known prevents boards from considering and pursuing new opportunities which conflict with the old rules.

► **Confused Roles** - Some boards assume that it is the job of the executive director to do the visionary thinking and that the board will sit and wait for direction and inspiration. This lack of clarity can result in boards that do not exercise visionary leadership because they do not think it is their job.
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► Past Habit - Time was when clients, members and consumers would just walk in through the door on their own. Viewing things in this way, boards did not consider marketplace pressures, or for that matter a competitive marketplace. All that has changed, yet for many boards their leadership style has not kept pace with this new awareness.

SEGMENT IV

Training of Directors

Need, objective and methodology

An important aspect of Board effectiveness would be appropriate attention to development and training of directors on the lines of management development and training. Director induction should be seen as the first step of the board’s continuing improvement. Investing in board development strengthens the board and individual directors. The normal expectation is that independent directors having been invited to join the Board due to their rich background and expertise, may not need any training. As the Board of Directors is primarily responsible for good governance practices, which is quite different from management, it calls for new areas of knowledge and different skills. Training should encompass both a thorough induction programme and an ongoing training and development opportunities for the board members. Since the Board composition is getting more diverse a system of formal training and evaluation is very important to foster trust, cohesion and communication among board members.

Director Induction

Induction procedures should be in place to allow new directors to participate fully and actively in board decision-making at the earliest opportunity. To be effective, new directors need to have a good deal of knowledge about the company and the industry within which it operates. It involves introducing the new directors to the people with whom they will be working and explaining how the board operates. It involves building up rapport, trust, and credibility with the other directors so that the new director is accepted by and can work with fellow directors.

Common methods of induction include:

Briefing papers
Internal visits
Introductions

An induction programme should be available to enable new directors to gain an understanding of:

- the company’s financial, strategic, operational and risk management position
- the rights, duties and responsibilities of the directors
- the roles and responsibilities of senior executives
- the role of board committees.

An induction kit should be given to new directors which should contain the following:

- Memorandum and Articles of Association with a summary of most important provisions
- Brief history of the company
- Current business plan, market analysis and budgets
- All relevant policies and procedures, such as a policy for obtaining independent professional advice for directors;
- Protocol, procedures and dress code for Board meetings, general meetings, staff social events,
site visits etc including the involvement of partners;
- Press releases in the last one year
- copies of recent press cuttings and articles concerning the company
- Annual report for last three years
- Notes on agenda and Minutes of last six Board meetings
- Board’s meeting schedule and Board committee meeting schedule
- Description of Board procedures.

**Directors Development Programme**

Professional development should not be treated as merely another training schedule rather it must be more structured so as to sharpen the existing skills and knowledge of directors. It is a good practice for boards to arrange for an ongoing updation of their members with changes in governance, technologies, markets, products, and so on through:

- Ongoing education
- Site visits
- Seminars; and
- Various short term and long term Courses

**Training of Independent Directors – Regulation 25 of SEBI (LODR) Regulations**

a. The company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc.

b. The details of such training imparted shall be disclosed in the Annual Report.

**PERFORMANCE REVIEW OF BOARD & INDIVIDUAL DIRECTOR**

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. Feedback about the performance of individual board members can help them enhance their skill as directors and can motivate them to be better board members. Evaluations can provide an ongoing means for directors to assess their performance. Board appraisals, if conducted properly produce a number of positive outcomes. In addition to the obvious benefit of greater board accountability, four areas of performance improvement have been identified:

1. more effective board operations,
2. better team dynamics and communication,
3. greater clarity with regard to member roles and responsibilities, and
4. improved CEO-board relations.

Soliciting feedback and reflecting on the board’s performance through a formal process encourages boards to pay greater attention to how they actually operate and in turn are very helpful in identifying ways to improve the board. As a result of such a process, suggestions and concerns about boardroom activities emerge more often and more constructively from board members.

Evaluations of group performance usually encourage a more through examination of an individual’s and a
group’s responsibilities and roles. Board evaluations are no exception. By focusing on the board as a team and on its overall performance, communication and overall level of participation also improves.

The performance appraisal of executive directors is judged by the performance/the operating results of the company. The performance appraisal of non-executive directors is complex. Normally companies use—

Self-appraisal

- peer review method wherein the every director’s performance is reviewed by the other directors.
- This is done under the direction of a lead independent director/chairman.

Proviso 2 to Section 178 of the Companies Act, 2013 provides that the Nomination and Remuneration Committee shall carry out evaluation of every director’s performance. Further, Schedule IV of the Companies Act, 2013 provides for the following evaluation mechanism of independent directors:

1. The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.

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

Section 134(2) (p) provides that in case of a listed company and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors shall be included in the report by Board of Directors

SEBI (LODR) Regulations provide following for the performance evaluation of independent directors:

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

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

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

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

Major Factors for Evaluation:

- The quality of the issues that get raised, discussed and debated at the meetings of the Board and its Committees.

- The guidance provided by the Board in the light of changing market conditions and their impact on the organisation.

- The methodology adopted by the Board to solve issues referred to them such as, the homework done by the Board on the problem presented to them, the information they seek to get a complete picture of the situation, the points of view presented to solve the issue, the harmonization of remedial measures proposed by the Board and ensuring the implementation of the solution by the management with appropriate and timely review mechanism.

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

→ Performance of the Board against the performance benchmarks set.
→ Overall value addition by the discussions taking place at the Board meetings.
→ The regularity and quality of participation in the deliberations of the Board and its Committees.
→ The answerability of the top management to the Board on performance related matters.

Model questions suggested in “Review of the role and effectiveness of non-executive directors” by Derek Higgs, January 2003 (Higgs Report) -

Performance evaluation of the board

• How well has the board performed against any performance objectives that have been set?
• What has been the board’s contribution to the testing and development of strategy?
• What has been the board’s contribution to ensuring robust and effective risk management?
• Is the composition of the board and its committees appropriate, with the right mix of knowledge and skills to maximize performance in the light of future strategy? Are inside and outside the board relationships working effectively?
• How has the board responded to any problems or crises that have emerged and could or should these have been foreseen?
• Are the matters specifically reserved for the board the right ones?
• How well does the board communicate with the management team, company employees and others? How effectively does it use mechanisms such as the AGM and the annual report? Is the board as a whole up to date with latest developments in the regulatory environment and the market?
• How effective are the board’s committees? (Specific questions on the performance of each committee should be included such as, for example, their role, their composition and their interaction with the board.)

The processes that help underpin the board’s effectiveness should also be evaluated. For eg.:

• Is appropriate, timely information of the right length and quality provided to the board and is management responsive to requests for clarification or amplification? Does the board provide helpful feedback to management on its requirements?
• Are sufficient board and committee meetings of appropriate length held to enable proper consideration of issues? Is time used effectively?
• Are board procedures conducive to effective performance and flexible enough to deal with all eventualities?

In addition, there are some specific issues relating to the chairman which should be included as part of an evaluation of the board’s performance, e.g.:

• Is the chairman demonstrating effective leadership of the board?
• Are relationships and communications with shareholders well managed?
• Are relationships and communications within the board constructive?
• Are the processes for setting the agenda working? Do they enable board members to raise issues and concerns?
• Is the company secretary being used appropriately and to maximum value?

**Performance Evaluation of The Non-Executive Director**

• The chairman and other board members should consider the following issues and the individual concerned should also be asked to assess themselves. For each non-executive director:

• How well prepared and informed are they for board meetings and is their meeting attendance satisfactory?

• Do they demonstrate a willingness to devote time and effort to understand the company and its business and a readiness to participate in events outside the boardroom, such as site visits?

• What has been the quality and value of their contributions at board meetings?

• What has been their contribution to development of strategy and to risk management?

• How successfully have they brought their knowledge and experience to bear in the consideration of strategy?

• How effectively have they probed to test information and assumptions? Where necessary, how resolute are they in maintaining their own views and resisting pressure from others?

• How effectively and proactively have they followed up their areas of concern?

• How effective and successful are their relationships with fellow board members, the company secretary and senior management?

• Does their performance and behavior engender mutual trust and respect within the board?

• How actively and successfully do they refresh their knowledge and skills and are they up to date with:
  ○ the latest developments in areas such as corporate governance framework and financial reporting?
  ○ the industry and market conditions?

• How well do they communicate with fellow board members, senior management and others, for example shareholders. Are they able to present their views convincingly yet diplomatically and do they listen and take on board the views of others?

The list excludes any specific questions about the performance of each non executive director on board committee, although some of the questions in this list could be made applicable to their committee in which they serve. (It may also be mentioned here that the Higgs suggestions do not include any list of questions for the evaluation performance of executive directors)

The list given above is not an exhaustive one or definitive and the corporate may design their own questions depending upon the approach of the company and having regard to the particular circumstances.

**CONCLUSION**

In today’s era where uncertainty has crept in to such an extent, that running a business is not as simple as it was when the demand for the commodity was easily identifiable, consumer was not much educated,
competitors were not playing, social responsibilities was not weighed and technology not ever changing.

Today, it has become imperative to have a board which through its strong ethics, values, independence, wisdom, acumen, perception and insight is able to direct the company towards the road to success. The board functions on the principle of majority or unanimity. A decision is taken on record if it is accepted by the majority or all of the directors. A single director cannot take a decision. However, every director should provide a creative contribution to the Board by providing objective criticism.

**LESsoN ROUND UP**

- The Board of Directors plays a pivotal role in ensuring good governance. The contribution of directors on the Board is critical to the way a corporate conducts itself.
- Responsibilities of Board - to establish an organizational vision and mission, giving strategic direction and advice, overseeing strategy implementation and performance, developing and evaluating the CEO, to ensure the organization has sufficient and appropriate human resources, ensuring effective stakeholder relations, risk mitigation, procuring resources.
- The board functions on the principle of majority or unanimity. A decision is taken on record if it is accepted by the majority or all of the directors. A single director cannot take a decision.
- Executive director or ED is a common post in many organisations, but the Companies Act does not define the phrase.
- Non-executive directors do not get involved in the day-to-day running of the business.
- Independent directors are known to bring an objective view in board deliberations. They also ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict.
- Board composition is one of the most important determinants of board effectiveness. A board should have a mix of inside/Independent Directors with a variety of experience and core competence if it is to be effective in setting policies and strategies and for judging the management’s performance objectively.
- The effectiveness of the board depends largely on the leadership skills, capabilities and commitment to corporate governance practices of each individual director.
- The Chairman’s primary responsibility is for leading the Board and ensuring its effectiveness.
- A board provides counsel to management and should not get involved in the day-to-day affairs of the organization. Clear expectations for the board and the director need to be established and maintained, because a board that is overly active in management can inhibit the organization’s effectiveness.
- Board and executive leadership need to work together based on mutual respect trust and commitment.
- Induction and continuous training of Directors is of utmost importance to keep them updated with latest happenings in the company and major developments that impact the company.
- A formal evaluation of the board and of the individual directors is one potentially effective way to respond to the demand for greater board accountability and effectiveness.
- An effective board evaluation requires the right combination of timing, content, process, and individuals.
- ICSI Recommendations to Strengthen Corporate Governance Framework – Post Satyam, the Council
of the Institute of Company Secretaries of India constituted a Core Group to analyse the issues arising out of Satyam Episode and to inter alia make suitable recommendations for policy and regulatory changes in the legal framework. The Core Group undertook a detailed study of the prevailing corporate governance practices across the world, the recommendations of various committees and corporate governance codes, the best practices adopted by the industry and after benchmarking the best practices that can be mandated, made its recommendations ‘ICSI recommendations to Strengthen Corporate Governance Framework’ which were approved by the Council of the Institute.

SELF TEST QUESTIONS

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

1. As a Company secretary of a company you are required to prepare a note to the Board explaining the importance of Board meetings in a good governance structure.

2. Should the role of Chairman and CEO be separated?

3. ABC Ltd. is a FMCG company. You as a company Secretary are required to prepare a draft of valid questions for the purpose of Board evaluation.

4. Write Short Notes on –
   (a) Board Composition
   (b) Training of Directors
   (c) Board Charter
   (d) Lead Independent Director
   (e) Board Evaluation
Lesson 6
Board Committees

LESSON OUTLINE

- Need and advantages of Committees Management
- Enhancing Effectiveness of Committees
- Audit Committee
- Nomination and Remuneration Committee
- Stakeholders Relationship Committee
- CSR Committee
- Other Committee
  - Corporate Governance Committee
  - Regulatory, Compliance and Government Affairs Committee
  - Science Technology and Sustainability Committee
  - Risk Management Committee
- 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 study 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.

“Committees have become so important nowadays that subcommittees have to be appointed to do the work”

- Laurence J. Peter
INTRODUCTION

With the globalization and the blurring of the borders, the demands on the board have increased tremendously. The regulatory requirements are complex and the onus on the Board is immense. In this scenario, the need to delegate oversight of certain areas to a specialist board committee has become imperative. However, it is to be remembered that even though the board delegates some of the responsibilities to a committee, the ultimate responsibility lies with the board.

Board committees with formally established terms of reference, criteria for appointment, life span, role and function constitute an important element of the governance process and should be established with clearly agreed reporting procedures and a written scope of authority. Committees enable better management of the board’s time and allow in-depth scrutiny and focused attention.

Since the Board of Directors is ultimately responsible for the acts of the committees, the role and structure of the board committees should be defined with due care.

NEED AND ADVANTAGES OF COMMITTEES MANAGEMENT

Board committees are pillars of corporate governance. In this background, the board constitutes various committees, statutory as well as non-statutory, as a means of improving board effectiveness and efficiency where more focused, specialized and technically oriented discussions are required. Committees prepare the groundwork for decision making and report at the subsequent board meetings. Further, committees enable better management of the board’s time and allow in-depth scrutiny and focused attention. It is a widely held view that committees:

- Review information in greater detail before it is placed before the board
- Manage issues with greater efficiency by having experts focusing on specific matters
- Provide an objective and independent insight into board’s functioning and judgment

The board must identify the requirements of the committee to support its work and responsibilities. As such, it lays down the terms of reference for each committee so created. The terms of reference comprise, a clear statement which describes the purpose of the committee, its membership composition, authority, major areas of responsibility and reporting mechanism to the board.

Greater specialization and intricacies of modern board work is one of the reasons for increased use of board committees. The reasons include:

- Responsibilities are shared.
- More members become involved.
- Specialized skills of members can be used to best advantage.
- Inexperienced members gain confidence while serving on the committee.
- Matters may be examined in more detail by a committee

The committees focus accountability to known groups. While the board as a legal unit always retains responsibility for the work of its Committees, the committee because of its focus on the mandate and the smaller size tends to be more effective. It is important that there is clarity of delegation and it should be
ensured that committees are not put between the Board and the CEO, either by giving committees official instructional authority or by allowing them to evaluate performance using their own criteria.

**Enhancing Effectiveness of Committees**

The following are the manifestations of an effective committee.

→ Committee Charter defining purpose of the committee.

→ Sensitivity to other’s needs; good communication among all members.

→ Good preparation on the part of the chair and members.

→ Access to independent professional advice when necessary.

→ Interested, committed members—Nomination to committees should be done taking into consideration the expertise, time commitment etc.

→ Periodic self assessment of committee’s performance.

→ Recognition and appreciation are given to members so that they feel they are really making a contribution.

→ The work of the committee is accepted and makes a valuable contribution to the organization.

**Membership In Committees**

Regulation 26 of SEBI (Listing Obligations and Disclosures) Regulation, 2015 provides that a director shall not be a member in more than ten 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.

**Explanation:**

1. For the purpose of considering the limit of the committees on which a director can serve, all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies and companies under Section 8 of the Companies Act, 2013 shall be excluded.

2. For the purpose of determination of the limit under this sub-clause, Chairmanship/membership of the Audit Committee and the Shareholders Grievance Committee alone shall be considered.

**ICSI Recommendations to strengthen Corporate Governance** suggests that the limits reckoned on membership/chairmanship of committees should include all the committees of listed companies on which such director is a member, whether such committees are mandatory or not. This should be on a ‘comply’ or ‘explain’ basis.

**VARIOUS COMMITTEES OF THE BOARD**

The following are some of the important committees of the Board:

- Audit Committee
- Shareholders Grievance Committee
- Nomination and remuneration committee
Audit Committee

A key element in the corporate governance process of any organization is its audit committee. The purpose of constitution of this committee is to make it responsible for the oversight of the quality and integrity of the company’s accounting and reporting practices; controls and financial statements; legal and regulatory compliance; the auditors’ qualifications and independence; and the performance of company’s internal audit function. The committee functions as liaison between the board of directors and the auditors- external & internal.

Regulatory Framework:

The Regulatory Framework with regard to Audit Committee is covered under:

- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
- Section 177 of Companies Act, 2013

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

A. Qualified and Independent Audit Committee

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

1. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.

2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

**Explanation (i):** The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

**Explanation (ii):** A member will 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.

3. The Chairman of the Audit Committee shall be an independent director;

4. The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;

5. 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, but on occasions it 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 present as invitees for the meetings of the audit committee;
6. The Company Secretary shall act as the secretary to the committee.

**B. Meetings of Audit Committee**

The Audit Committee should meet at least four times in a year and not more than one hundred & twenty days 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 there should be a minimum of two independent members present.

**C. Powers of Audit Committee**

The Audit Committee shall have powers, which should include the following:

1. To investigate any activity within its terms of reference.
2. To seek information from any employee.
3. To obtain outside legal or other professional advice.
4. To secure attendance of outsiders with relevant expertise, if it considers necessary.

**D. Role of Audit Committee**

The role of the Audit Committee shall include the following:

1. 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;
2. Recommendation for appointment, remuneration and terms of appointment of auditors of the company;
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. Qualifications 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. Review and monitor the auditor’s independence and performance, and effectiveness of audit process;

8. Approval or any subsequent modification of transactions of the company with related parties;

9. Scrutiny of inter-corporate loans and investments;

10. Valuation of undertakings or assets of the company, 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 CFO (i.e., the whole-time Finance Director or any other person heading the finance function or discharging that function) 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.

E. Review of information by Audit Committee

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.

Section 177 of the Companies Act, 2013

The Act has enlarged the responsibilities of auditors to include monitoring of auditors’ independence,
valuation of their performance, approval of modification of related-party transactions, scrutiny of loans and investments, valuation of assets and evaluation of internal controls and risk management. They have to establish a vigil mechanism and protection for any whistle-blower. The members must be able to understand financial statements and have a majority of Independent Directors. Large companies must mandatorily have professional internal auditors.

1. The requirement of constitution of Audit Committee has been limited to:

   (a) Every listed Companies; or
   (b) The following class of companies –
      (i) all public companies with a paid up capital of ten crore rupees or more;
      (ii) all public companies having turnover of one hundred crore rupees or more;
      (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures; or deposits exceeding fifty crore rupees or more.

Explaination - 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.

2. The Committee shall comprise of minimum 3 directors with majority of the directors being Independent Directors. The majority of members of audit committee including its chairperson shall be person with ability to read and understand the financial statement.

3. A transition period of one year from the date on which the new Act comes into effect has been provided to enable companies to reconstitute the Audit Committee.

4. The terms of reference of the Audit Committee have now been specified and inter alia includes, -

   (i) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;
   (ii) review and monitor the auditor’s independence and performance, and effectiveness of audit process;
   (iii) examination of the financial statement and the auditors’ report thereon;
   (iv) approval or any subsequent modification of transactions of the company with related parties;
   (v) scrutiny of inter-corporate loans and investments;
   (vi) valuation of undertakings or assets of the company, wherever it is necessary;
   (vii) evaluation of internal financial controls and risk management systems;
   (viii) monitoring the end use of funds raised through public offers and related matters.

5. The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

6. The audit committee hold the authority to investigate into matters or referred by the Board and have the powers to obtain professional advice from external sources and have full access to records of the company.
7. In addition to the auditor, the KMP shall also have a right to be heard in the meetings of the Audit Committee when it considers the auditor’s report, though they shall not have voting rights.

8. 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 genuine concerns or grievances (Rule 7):

   (1) The companies which accept deposits from the public;

   (2) The companies which have borrowed money from banks and public financial institutions in excess of fifty crore rupees.

9. 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 has 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.

10. 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.

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

12. 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.

13. The Vigil Mechanism shall operate for directors and employees to enable them to bring to report genuine concerns. Further the said mechanism shall provide safeguards against victimization and provide for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases.

14. The details of establishment of the Vigil Mechanism is required to be disclosed by the company on its website, if any and in the Board’s report.

**Default**

If a default is made in complying with the provisions of section 177 of the Companies Act, 2013, the company and every officer who is in default, shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to fifty thousand rupees or with both.

**Nomination and Remuneration Committee**

The Nomination and Remuneration Committee helps the Board of Directors in the preparation relating to the election of members of the Board of Directors, and in handling matters within its scope of responsibility that relate to the conditions of employment and remuneration of senior management, and to management’s and personnel’s remuneration and incentive schemes. The responsibilities of the Remuneration and Nomination Committee are defined in its policy document.

**SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015**

In terms of the amended SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015,
companies are required to constitute Nomination and Remuneration Committee. The provisions with regard Nomination and Remuneration Committee are as under:

A. The company shall set up a nomination and remuneration committee which shall comprise at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairman of the committee shall be an independent director.

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

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

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

3. Devising a policy on Board diversity;

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

C. The Chairman of the nomination and remuneration committee could be present at the Annual General Meeting, to answer the shareholders’ queries. However, it would be up to the Chairman to decide who should answer the queries.

Section 178 of companies Act, 2013

The Nomination and Remuneration Committee helps the Board of Directors in the preparations relating to the election of members of the Board of Directors, and in handling matters within its scope of responsibility that relate to the conditions of employment and remuneration of senior management, and to management's and personnel's remuneration and incentive schemes.

Except for certain large listed companies, the importance of constitution of the Nomination and remuneration Committee has not been realised fully in India. The Board of directors of following companies shall constitute

Nomination and Remuneration Committee of the Board:

(a) Every listed Companies; or

(b) The following class of companies –

(i) all public companies with a paid up capital of ten crore rupees or more;

(ii) all public companies having turnover of one hundred crore rupees or more;

(iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

The committee shall consist of three or more non-executive directors out of which not less than one-half shall be independent directors. The chairperson of the company may be appointed as member, but shall not chair such committee. The Committee shall identify the person qualified to become directors and may be appointed in senior management and recommend their appointment and removal and also carry out evaluation of every director. The Committee shall formulate the criteria, for determining qualifications, positive attributes and independence of a director and recommend to the Board the policy relating to remuneration for directors, KMPs and other employees.
While formulating its policy, the Nomination and Remuneration Committee shall ensure that

(a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate the directors

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

(c) remuneration to Directors, KMP and senior management involves a balance between fixed and incentive pay reflecting short and long term performance objectives which are suited to the working of the company and its objectives.

The Nomination and Remuneration Committee shall, while formulating the policy under sub-section (3) 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: Provided that such policy shall be disclosed in the Board’s report.

Duties of the Nomination and Remuneration Committee

The duties of the Nomination and Remuneration Committee have now been specified. They include:

(a) identifying persons who are qualified to become Directors and who may be appointed in senior management in accordance with the criteria laid down;

(b) recommend to the Board their appointment and removal;

(c) carry out evaluation of every Director’s performance;

(d) formulate the criteria for determining qualifications, positive attributes and independence of a Director and

(e) recommend to the Board a policy, relating to the remuneration for the Directors, KMP and other employees.

The Stakeholders Relationship Committee

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 mandates that a committee under the Chairmanship of a non-executive director and such other members as may be decided by the Board of the company shall be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. This Committee shall be designated as ‘Stakeholders Relationship Committee’ and shall consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends.

Section 178(5) of the Companies Act, 2013 provides for constitution of the Stakeholders Relationship Committee. The Board of a company that has more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year is required to 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. The Stakeholders Relationship Committee shall consider and resolve the grievances of security holders of the company.

The chairperson of each of the committees constituted under this section or, in his absence, any other member of the committee authorised by him in this behalf shall attend the general meetings of the company.

**Corporate Social Responsibility (CSR) Committee**

Companies Act 2013 provides for constitution of CSR Committee of the Board to formulate and monitor the CSR Policy of a company for certain specified companies. The details of CSR committee is discussed in Chapter 13 of this study material.

**Other Committees**

In addition to the Committees of the Board mandated by the Companies Act, 2013 viz, Audit Committee, Nomination and Remuneration Committee, Stakeholders Relationship Committee and the CSR Committee, Board of Directors 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:

**Corporate Governance Committee**

The Corporate Governance Committee is responsible for considering and making recommendations to the Board concerning the appropriate size, functions and needs of the Board. The Corporate Governance Committee may, at its sole discretion, engage director search firms and has the sole authority to approve the fees and other retention terms with respect to any such firms. The Corporate Governance Committee also has the authority, as necessary and appropriate, to consult with other outside advisors to assist in its duties to the Company.

A company may constitute this Committee to develop and recommend the board a set of corporate governance guidelines applicable to the company, implement policies and processes relating to corporate governance, to review, periodically, the corporate governance guidelines of the company. Many companies give the mandate of corporate governance to nomination committee and is given the nomenclature Nomination and Corporate Governance Committee.

Typically, the committee may be responsible for considering matters relating to corporate governance including the composition of board, appointment of new directors, review of strategic human resource decisions, succession planning for the chairman and other key board and executive positions, performance evaluation of the board and its committees and individual directors.

**Regulatory, Compliance & Government Affairs Committee**

The primary objective of the Compliance Committee is to review, oversee, and monitor:

- the Company’s compliance with applicable legal and regulatory requirements,
- the Company’s policies, programmes, and procedures to ensure compliance with relevant laws, the Company’s Code of Conduct, and other relevant standards;
- the Company’s efforts to implement legal obligations arising from settlement agreements and other similar documents; and
- perform any other duties as are directed by the Board of Directors of the company.
The committee oversees the Company’s non-financial compliance programmes and systems with respect to legal and regulatory requirements. Besides, it also oversees compliance with any ongoing Corporate Integrity Agreements or any similar undertakings by the Company with a government agency. Section 134 (5) of the Act dealing with Directors Responsibility Statement states that the directors need to ensure that they have devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively. Essentially, this responsibility ought to be the bulwark of the charter of this committee.

**ICSI Recommendations to strengthen Corporate Governance framework suggests** for constitution of Corporate Compliance Committee on mandatory basis in respect of all public limited companies having a paid-up capital of `5 crore or more.

The charter of the committee may include:

- To oversee the Company’s compliance efforts with respect to relevant Company policies, the Company’s Code of Conduct, and other relevant laws and regulations and monitor the Company’s efforts to implement legal obligations arising from agreements and other similar documents;
- To review the Company’s overall compliance programme to ensure that it is well communicated, supports lawful and ethical business conduct by employees, and reduces risk to the Company for non-compliance with laws and regulations related to the Company’s business;
- To review complaints received from internal and external sources, regarding matters other than the financial matters which are within the purview of the Audit Committee;
- To periodically present to the Board for adoption appropriate changes to the policies, and oversee implementation of and compliance with these policies;
- To review regularly the company’s compliance risk assessment plan;
- To investigate or cause to be investigated any significant instances of non-compliance, or potential compliance violations that are reported to the committee;
- To coordinate with other committees regarding matters brought to the committees attention that relate to issues of compliance with applicable laws and regulations;
- Regularly report to the Board on the Committee’s activities, recommendations and conclusions;
- To discuss any significant compliance issues with the Chief Executive officer;
- To periodically report to the Board and CEO on the adequacy and effectiveness of the company’s compliance programme;
- To retain at the company’s expense, independent advisors to assist the committee with carrying out its responsibilities from time to time;
- To perform such other duties and responsibilities as may be assigned to the committee by the board.

Other than those duties and responsibilities mentioned in the recommendatory charter following may also be the duties and responsibilities that can be delegated to the committee:

- Review and monitor the Company’s compliance training initiatives on various topics, including but not limited to acceptable forms of compensation, conflicts of interest, competition and trade practices.
- Review the policies, programmes and procedures for ensuring compliance with relevant laws, the
Company’s Code of Conduct, value statement, other relevant standards, and legal obligations, including those imposed by settlement agreements.

- Present to the Board for adoption policies, periodically present to the Board for adoption appropriate changes to the policies, and oversee implementation of and compliance with these policies.
- Review and reassess the Charter’s adequacy, as appropriate, and recommend any proposed changes to the Board for approval.
- Reviews the organization, implementation and effectiveness of the Company’s health care compliance & ethics and quality & compliance programs.
- Oversees the Company’s Policy on Business Conduct and Code of Business Conduct & Ethics for Members of the Board of Directors and Executive Officers.
- Reviews the Company’s governmental affairs policies and priorities and other public policy issues facing the Company.
- Reviews the policies, practices and priorities for the Company’s political expenditure and lobbying activities.

**Science, Technology & Sustainability Committee**

It is composed of non-employee Directors, determined to be “independent” under the listing standards of the New York Stock Exchange. It:

- Monitors and reviews the overall strategy, direction and effectiveness of the Company’s research and development.
- Serves as a resource and provides input, as needed, regarding the scientific and technological aspects of product safety matters.
- Reviews the Company’s policies, programmes and practices on environment, health, safety and sustainability.
- Assists 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.
- Assists 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.

**Risk Management Committee**

A company needs to have a proactive approach to convert a risk into an opportunity. A business is exposed to various kind of risks such as strategic risk, data security risk, fiduciary risk, credit risk, liquidity risk, reputational risk, environmental risk, competition risk, fraud risk, technological risk etc. It is important for the company to have a structured framework to satisfy that it has sound policies, procedures and practices in place to manage the key risks under risk framework of the company. A risk management Committee’s role is to assist the Board in establishing risk management policy, overseeing and monitoring its implementation.

The committee shall be constituted with at least three directors, majority being independent directors.

**Major functions include:**

- Assisting the Board in fulfilling its risk management oversight responsibilities with regard to identification, evaluation and mitigation of operational, strategic and external environment risks.
- To ensure that management has instituted adequate process to evaluate major risks faced by the
Establishing the role and responsibilities of officers/team who shall be responsible for:
- Facilitating the execution of risk management practices in the enterprise
- Reviewing enterprise risks from time to time, initiating mitigation actions, identifying owners and reviewing progress
- Reporting risk events and incidents in a timely manner

- Monitoring and reviewing risk management practices of the Company
- Reviewing and approving risk-related disclosures.

SEBI (LODR) Regulations 2015 provides for the constitution of Risk Management Committee 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 executive of the listed entity may be members of the committee.
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.
5. The provisions of this regulation shall be applicable to top 100 listed entities, determined on the basis of market capitalization, as at the end of the immediate previous financial year.

Companies depending upon the need may have more committees like:
- Strategies Committee
- Capital Expenditure (Capex) Committee
- HR Committee
- Project Appraisal Committee

### LESSON ROUND UP

- With the globalization and the blurring of the borders, the demands on the board have increased tremendously. The regulatory requirements are complex and the onus on the Board is immense. In this scenario, the need to delegate oversight to a board committee has become imperative.
- 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 prepare the groundwork for decision-making and report at the subsequent board meeting.
- 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.
- The Regulatory Framework with regard to Audit Committee is covered under (LODR) Regulations, 2015 and Section 177 of Companies Act, 2013.
- A committee under the Chairmanship of a non-executive director and such other members as may be decided by the Board of the company shall be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. This Committee shall be designated as ‘Stakeholders Relationship Committee’ and shall consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends.

- Other committees – Corporate Governance Committee, Compliance Committee, Risk Management Committee, Ethics Committee, Strategies Committee, Capital Expenditure (Capex) Committee, etc.

- Nomination and Remuneration Committee: Nomination and Remuneration Committee as the name suggests is constituted by a company is to determine the qualification and remuneration packages of executive directors/ chief executive officers.

- Corporate Governance Committee: A company may constitute this committee to develop and recommend the board a set of corporate governance guidelines applicable to the company, implement policies and processes relating to corporate governance principles, to review, periodically, the corporate governance guidelines of the company.

- Corporate Compliance Committee: The primary objective of the Compliance Committee is to review, oversee, and monitor the Company’s compliance with applicable legal and regulatory requirements, its policies, programs, and procedures to ensure compliance with relevant laws, its Code of Conduct, and other relevant standards.

- Risk Management Committee: A business is exposed to various kind of risk such as strategic risk, data-security risk, fiduciary risk, credit risk, liquidity risk, reputational risk, environmental risk, competition risk, fraud risk, technological risk etc. A risk management Committee’s role is to assist the Board in establishing risk management policy, overseeing and monitoring its implementation.

**SELF TEST QUESTIONS**

1. What is the need and what are the advantages of Committee Management?

2. Discuss in detail about remuneration committee.

3. Explain the importance of constitution of Risk Management Committee?
Lesson 7
Corporate Governance and Shareholders Rights

LESSON OUTLINE

- Introduction
- Rights of Shareholders
- Protection of Rights of Minority Shareholders,
- Challenges in exercising shareholders rights
- Investor Protection in India
- Shareholder Activism
- Investor Relations
- OECD Principles of Corporate Governance
- Role of Institutional Investors in promoting good Corporate Governance
- Institutional Investors – Global Trends
- The UK Stewarding Code
- Principles for Responsible Investment (PRI)
- CRISA
- California Public Employees’ Retirement System
- Tools used by Institutional Investors
- Conclusion
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to understand what the rights of the shareholders are and how it is important from corporate governance perspective.

In this study lesson, the rights of shareholders as recommended in the OECD Principles on Corporate Governance and the provisions in the Companies Act, 2013 and the Listing Agreement which deals with shareholder rights have been covered. The challenges in exercising the shareholders rights have also been discussed.

The Study covers how the interests of minority shareholders may be protected in light of related party transactions; the study explains about shareholder activism and the role that institutional shareholders can play in prompting good corporate governance. To enable student to understand the global trends on the subject, international codes like UK Stewardship Code, UN Principles on Responsible Investment, The Code for Responsible Investing in South Africa (CRISA), CALpers corporate engagement process have been covered.

“Committees have become so important nowadays that subcommittees have to be appointed to do the work”

-Laurence J. Peter
Protection of shareholder rights is sacrosanct for good corporate governance. It is one of the pillars of corporate governance. For the efficient functioning of the capital market, the fundamental requirement is that the investor rights are well protected. The Preamble to Securities and Exchange Board of India Act, 1992 reads as under:

“An Act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected 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.

In the international context, the OECD Principles on Corporate Governance which serves as an international benchmark for policy makers, investors, corporations and other stakeholders worldwide also has made extensive recommendations as to the shareholder rights.

## Rights of Shareholders

### 2.1. Under the Companies Act, 2013

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

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<tbody>
<tr>
<td>i</td>
<td>To receive share certificates as title of their holdings</td>
</tr>
<tr>
<td>ii</td>
<td>To transfer shares</td>
</tr>
<tr>
<td>iii</td>
<td>To received dividend when declared</td>
</tr>
<tr>
<td>iv</td>
<td>To have right shares</td>
</tr>
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<td>v</td>
<td>To appoint directors</td>
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<tr>
<td>vi</td>
<td>To share the surplus assets on winding up</td>
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<td>vii</td>
<td>Right to be exercised collectively in respect of making application to the Central government for investigation of the affairs of the company. 210 01.04.2014 235</td>
</tr>
<tr>
<td>viii</td>
<td>Right to make application collectively to the Company Law Board/ Tribunal for oppression and mismanagement</td>
</tr>
<tr>
<td>ix</td>
<td>Right of Nomination 72 01.04.2014 109A, 109B</td>
</tr>
<tr>
<td>x</td>
<td>Right to vote in proportion to his share of the paid-up equity share capital of the company</td>
</tr>
<tr>
<td>xi</td>
<td>Variation of Shareholder’s right 46, 48 01.04.2014 Not yet Notified 106 107</td>
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5. In case of winding up:

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<tr>
<td>i</td>
<td>Voluntary winding up 304 Not yet notified 484</td>
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</table>
Winding up of a company in case of oppression and mismanagement

Rights of Shareholder under the SEBI (Prohibition of Insider Trading) Regulations 2015

Chapter II deals with the Restrictions on Communication and Trading by Insiders. Regulation 3(3)(i) provides that Notwithstanding anything contained in this regulation, an unpublished price sensitive information may be communicated, provided, allowed access to or procured, in connection with a transaction that would:

(i) entail an obligation to make an open offer under the takeover regulations where the board of directors of the company is of informed opinion that the proposed transaction is in the best interests of the company;

Note provided under this Regulation: It is intended to acknowledge the necessity of communicating, providing, allowing access to or procuring UPSI for substantial transactions such as takeovers, mergers and acquisitions involving trading in securities and change of control to assess a potential investment. In an open offer under the takeover regulations, not only would the same price be made available to all shareholders of the company but also all information necessary to enable an informed divestment or retention decision by the public shareholders is required to be made available to all shareholders in the letter of offer under those regulations.

Rights of shareholders under SEBI(LODR) Regulations, 2015

(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.

### Protection of Rights of Minority shareholders

Companies Act, 2013 provides for some measures to protect the interest of minority shareholders. It includes the following:

- Where a company, which has raised money from public through prospectus and still has any unutilized amount out of the money so raised and which proposes to change its objects, then the promoter and shareholders having control of a company are required to provide an exit to the dissenting shareholders in accordance with regulations to be specified by SEBI.

- Where any benefit accrues to promoter, director, manager, KMP, or their relatives, either directly or indirectly as a result of non-disclosure or insufficient disclosure in the explanatory statement annexed to the notice of general meeting then such persons shall hold such benefit in trust for the company and shall be liable to compensate the company to the extent of the benefit received by him.

- **Class Action Suit:** New concept of Class Action Suit has been introduced. In case of oppression / mismanagement, specified number of members or depositors is entitled to file Class Action Suit before NCLT for seeking prescribed reliefs. They may also claim damages / compensation for fraudulent / unlawful / wrongful acts from or against the company / directors / auditors / experts / advisors etc. Some of the actions that can be taken are as under: –
  - Restrain company from any act which is ultra vires the AOA / MOA
  - Restrain company for breach of provisions of MOA / AOA, Act or any other law
  - Declare a resolution void if material facts are not provided
  - Restraint company/ directors from acting on such resolutions
  - Restrain company from taking action contrary to any resolution passed by shareholders
  - Claim damages or compensation or demand any other suitable action
  - Seek other remedies as Tribunal may deem fit

### Challenges in exercising shareholders rights

Principle III of the OECD Principles on Corporate Governance states that the corporate governance
framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

The rights of shareholders have been well secured in the legislative framework. That is to say that the law is in place to secure the rights of the shareholders. All shareholders of the same class have the same rights. If that be so what is the challenge? In this section we will discuss the challenges.

Shareholders can be classified as dominant shareholders and minority shareholders. In general parlance dominant shareholders are those, who by virtue of their majority shareholding or their association with the company as its founders or for any other reason are able to exercise control in the management of the company.

One of the basic challenges in exercising the shareholder rights stems from information asymmetry between the dominant shareholders and the minority shareholders. This could be attributed to lack of timely disclosure of accurate information on important matters which is crucial for the protection of shareholders’ rights for two main reasons. First, shareholders need to have access to information about important matters to make decisions that are in their interests. Second, information disclosure is crucial in preventing managers and dominant shareholders from engaging in activities that are detrimental to minority shareholders.

Another major challenge arises on account of lack of awareness amongst the small shareholders as their rights leading towards a passive approach to voting.

Investor Protection in India

Securities and Exchange Board of India (SEBI) is the capital market regulator and nodal agency in India who regulates the security market. One of the objectives of the SEBI is to provide a degree of protection to the investors and to safeguard their rights, steady flow of savings into market and to promote the development of and regulate the securities market.

Investors should be safeguarded not only against frauds and cheating but also against the losses arising out of unfair practices. Such practices may include:

- Deliberate misstatement in offer statements to investors
- Price manipulations
- Insider trading.

SEBI has issued many guidelines and regulations to regulate the capital market and to protect the investors. Some of the guidelines are:

- SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (Refer Para 2.2. of this lesson for details)
- SEBI (Ombudsman) Regulation 2003 – designed to redress the investor’s grievance against listed companies or intermediaries or both for amicable settlement;
- SEBI (Prohibition of fraudulent and unfair Trade Practices relating to securities market) Regulations 2003 – to prohibit any fraudulent and unfair Trade Practices relating to securities market;
- SEBI (Prohibition of Insider Trading ) Regulations 2015. The basic objective is to prohibit persons who have more access to company’s information which can be used to benefit the individual or group of individual or agency.
• In addition to the above, SEBI has set up a separate cell to address the grievances of investors - SEBI Complaints Redressal Sysstem (SCORES).

Investor Education & Protection Fund: Investor Education and Protection Fund (IEPF) is established under section 205C of Companies Act, 1956. Since the relevant provision under new act (Section 125 of CA 2013) has not yet notified hence the provisions of Section 205C is applicable.

Investor Education and Protection Fund (awareness and protection of investors) Rules, 2001 stipulate the activities related to investors’ education, awareness and protection for which the financial sanction can be provided under IEPF.

• An initiative of Ministry pursues following activities as stipulated under Rules
• Investor Education programme through Media
• Organizing Seminars and Symposia
• Proposals for registration of Voluntary Associations or Institution or other organizations engaged in Investor Education and Protection activities
• Proposals for projects for Investors’ Education and Protection including research activities and proposals for financing such projects
• Coordinating with institutions engaged in Investor Education, awareness and protection activities

The Securities and Exchange Board of India (SEBI) also notified SEBI (Investor Protection and Education Fund) Regulations, 2009 according to which SEBI will establish an Investor Protection and Education Fund which will be used inter-alia, for “aiding investors’ associations recognized by the Board to undertake legal proceedings in the interest of investors in securities that are listed or proposed to be listed” – clause 5 (2) (d) of the Regulations. This amendment is a path-breaking one and is believed to set shareholder activism in India. Through this an attempt is being made to provide incentive to class action litigations. Though a regime has started yet much is needed to make such litigations successful in India.

### Shareholders Activism

Shareholders can ensure that the company follows good corporate governance practices and implements beneficial policies. Shareholder activism refers to the active involvement of stockholders in their organization. Active participation in company meetings is a healthy practice. They can resolve issues laid down in the annual and other general meetings and can raise concerns over financial matters or even social causes such as protection of the environment. Shareholder activists include public pension funds, mutual funds, unions, religious institutions, universities, foundations, environmental activists and human rights groups.

A share in a company is not only a share in profits but also a share in ownership. Shareholders must realize that their active participation in the company’s operations ensures

• better management,
• less frauds and
• better governance.

The corporate crisis that looms today - shareholder activism - is with different actors but the same stories. In the 90’s it was hostile takeovers. Today it is hostile hedge funds frustrated with performance and employing new strategies to improve overall returns. Ironically, shorter term investors that once “voted with their feet” are now taking the long road of shareholder activism.
History of Shareholder Activism

Shareholder activism can be traced back 80 years when Henry Ford chose to cancel a special dividend and instead spend the money on advancing social objectives. The court ultimately sided with dissented shareholders, reinstated the dividend, sparking a new paradigm in shareholder activism.

In the late 1980’s, shareholder activism took a more aggressive turn with corporate raiders like Paul Getty. Shareholders took on management, The New Crisis: Shareholder Activism Ashton Partners engaging in hostile takeovers and leveraged-buyouts to gain control of undervalued and underperforming companies.

In the 1990’s shareholder activism found mainstream pension fund managers like CalPERS pushing for the repeal of staggered boards and poison pills. These players used a form of “quiet” activism – favoring abstentions and withholding votes for important proxy issues – as a way to influence management and Board decisions.

The purpose of shareholder activism is to

- Provide an overview of shareholder activist, and how it may influence a company’s behaviour,
- Identify what options are available for shareholders wishing to pursue an activist agenda, and
- Consider the legal framework in which UK public companies must operate when faced with shareholder activism.

Shareholder activism can be exercised through proxy battles, publicity campaigns, shareholder resolutions, litigation and negotiations with management. For example,

- Shareholder activism played a major role in eradicating apartheid in South Africa through divestment.
- Shareholders have also influenced the phasing out of polystyrene products at McDonalds.
- More recently, shareholders were able to bring public pressure and media attention on Home Depot to stop the use of wood from environmentally sensitive areas.

The shareholder activism means

- Establishing dialogue with the management on issues that concern
- Influencing the corporate culture.
- Using the corporate democracy provided by law.
- Increasing general awareness on social and human rights issues concerning the organization.

Internet and mass media are effective tools in building up pressure on the management.

Shareholder activism often highlights differences in strategy or poor communication. In numerous activist situations companies believing they’ve told one story, and the investment community hearing another, or nothing at all. Inconsistency in messaging and lack of information breed investor discontent, and ultimately shareholder activism. If ignored long enough, the situation comes to a breaking point where activist investors choose a drastic approach.

Investor Relations (IR)

Investor Relations (IR) is a strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between a
company, the financial community, and other constituencies, which ultimately contributes to a company’s securities achieving fair valuation.

Typically, investor relation is a department or person reporting to the Chief Financial Officer. In some companies, investor relation is managed by the public relations or corporate communications departments, and can also be referred to as “financial public relations” or “financial communications”.

Many larger publicly-traded companies now have dedicated IR officers (IROs), who oversee most aspects of shareholder meetings, press conferences, private meetings with investors, (known as “one-on-one” briefings), investor relations sections of company websites, and company annual reports. The investor relations function also often includes the transmission of information relating to intangible values such as the company's policy on corporate governance or corporate social responsibility. Recently, the field has trended toward an increasingly popular movement for “interactive data”, and the management of company filings through streaming-data solutions such as XBRL or other forms of electronic disclosure have become prevalent topics of discussion amongst leading IROs worldwide.

The investor relations function must be aware of current and upcoming issues that an organization or issuer may face, particularly those that relate to fiduciary duty and organizational impact. In particular, it must be able to assess the various patterns of stock-trading that a public company may experience, often as the result of a public disclosure (or any research reports issued by financial analysts). The investor relations department must also work closely with the Company Secretary on legal and regulatory matters that affect shareholders.

IRO’s have access to the Chief Executive Officer (CEO) and Chairman or President of the corporation. This means that being able to understand and communicate the company’s financial strategy, they are also able to communicate the broader strategic direction of the corporation and ensure that the image of the corporation is maintained in a cohesive fashion.

Due to the potential impact of legal liability claims awarded by courts, and the consequential impact on the company’s share price, IR often has a role in crisis management of, for example, corporate downsizing, changes in management or internal structure, product liability issues and industrial disasters.

The most highly-regarded professional member organization for Investor Relations in the United States is the National Investor Relations Institute, or NIRI. In the United Kingdom, the recognized industry body is The Investor Relations Society, while in Canada, the professional association is called the Canadian Investor Relations Institute, or CIRI. Australia’s professional organization is known as the Australian Investor Relations Association (AIRA).

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<tr>
<th>ICSI Recommendations to strengthen Corporate Governance Framework</th>
<th>recommends Constitution of Investor Relations Cell should be made mandatory for Listed Companies. The Investor Relations Meet after declaration of financial results should be compulsorily webcast in case of companies having a market capitalization of Rs.1000 Crore or more.</th>
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**The Sarbanes-Oxley Act**: The Sarbanes-Oxley Act of 2002 significantly increased the importance of investor relations in the financial markets. The act established new requirements for corporate compliance and regulatory governance, with an increased emphasis on accuracy in auditing and public disclosure. Notable provisions of the act which apply to investor relations include enhanced financial disclosures and
accuracy of financial reports, real-time disclosures, off-balance-sheet transaction disclosures, pro-forma financial disclosures, management assessment of internal controls, and corporate responsibility for financial reports. More specifically, Sarbanes-Oxley sections 301, 302, 404, and 802 have been of particular interest to companies improving corporate compliance. Similar to Sarbanes-Oxley are Bill 198 in Canada, LSF in France, and J-SOX in Japan. The European MiFID (Markets in Financial Instruments Directive), although principally concerned with investor protection, also covers regulation and compliance for listed European companies.

If the latest collection of balance sheets is any indication, corporate India is increasingly paying attention to investor relations, courtesy IROs whose roles are being fine-tuned like never before. Companies are strengthening their investor relations departments, multi-tasking them and hiring more people for improved investor communication.

**Reporting Standards:** Companies these days need to disclose much more. The current legal requirements are prompting companies to refine their reporting standards too. The job-profile of IROs is changing as a result. IROs provide definite inputs to boards of directors and become part of companies’ disclosure committees.

**Investor Confidence:** The responsibilities of the IRO, include:

- building interest in the firm on the buy side,
- anticipate market reaction towards M&As and divestitures,
- and building investor confidence in the firm.

Companies frequently need to convey important messages to shareholders, some of them related to performance and strategy, point out investment circles. “Communications these days is not merely about meetings with stakeholders.”

**OECD Principles of Corporate Governance**

Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance were first released in May 1999 and revised in 2004. The principles are one of the 12 key standards for international financial stability of the Financial Stability Board and form the basis for the corporate governance component of the Report on the Observance of Standards and Codes of the World Bank Group. The OECD Principles are currently under review.

**The OECD Principles of Corporate Governance are:**

I. Ensuring the Basis for an Effective Corporate Governance Framework.

II. The Rights of Shareholders and Key Ownership Functions

III. The Equitable Treatment of Shareholders

IV. The Role of Stakeholders in Corporate Governance

V. Disclosure and Transparency

VI. The Responsibilities of the Board

**The OECD Principles II and III are very much relevant for this chapter and are described as under:**

**Principle II:** The Rights of Shareholders and Key Ownership Functions: The corporate governance framework should protect and facilitate the exercise of shareholders’ rights.
Lesson 7  =  Corporate Governance and Shareholders Rights  203

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 have the right to participate in, and to be sufficiently informed on, 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. 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.
3. 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 on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.
4. 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.

D. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

E. 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.

F. The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.

1. 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.

2. 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.

G. 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.

Principle III - The Equitable Treatment of Shareholders: The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

A. All shareholders of the same series of a class should be treated equally.

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 voting rights should be subject to approval by those classes of shares which are negatively affected.

2. 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.

3. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.

4. Impediments to cross border voting should be eliminated.

5. 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.

B. Insider trading and abusive self-dealing should be prohibited.

C. 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.

Role of Institutional Investors in Promoting Good Corporate Governance

Institutional investors are financial institutions that accept funds from third parties for investment in their own name but on such parties’ behalf. They include pension funds, mutual funds and insurance companies.

There are difference of opinion among the writers on the role of Institutional Investors in promoting good corporate governance. Wharton, Lorsch, and Hanson (1991) argue that institutional investors need not take active interest in the corporate governance of a company because the institutional investors have their
primary fiduciary responsibility to their own investors and beneficiaries, which can lead to a conflict of interest with their acting as owners. Admati, Pfleiderer and Zechner (1994), Black (1990), Coffee (1991), and Monks (1995) have argued that absence of appropriate incentives and free rider problems hinder institutional activism efforts. The free rider problem comes because even when one institutional investor interferes, the other investors get the benefits. Hence, the costs associated with active monitoring are borne by only one investor and this discourages active intervention. Charkham (1994) divides the institutional investors into two categories, which he calls Type A and Type B. Type A institutions have a portfolio of a very small number of companies. Their stake in each individual company is very large. These institutions also keep a close relationship with the companies. Type B institutions, on the other hand, manage a widely diversified portfolio. These companies treat the shares as commodities with no intrinsic qualities other than that of being tradable commodities. According to Charkham, corporate governance system fails because most institutions fall in the Type B category. Here only the Type A institutional investors have got an incentive for active monitoring for it directly affects the portfolio value. The above arguments are based on the premise that the investment objectives and the compensation system in the institutional investing companies often discourage their active participation in the corporate governance system of the companies. Another reason often cited by these people is that the institutional investors are not competent enough to interfere in the activities of the companies. Cordtz (1993) has argued that the institutional investors lack the expertise and ability to serve as effective monitors. The Cadbury committee (1992), for example, states that “because of their collective stake, we look to the institutions in particular, with the backing of the Institutional Shareholders’ Committee, to use their influence as owners to ensure that the companies in which they have invested comply with the code” (para 6.16). The working group on corporate governance of Harvard Business Review has, similarly, concluded "the institutional investors of public companies should see themselves as owners and not as investors. In India, the CII report on corporate governance has also brought out the importance of the role that the institutional investors can play in the corporate governance of a company. The Kumar Mangalam Birla committee on corporate governance (henceforth SEBI committee) similarly emphasizes the role that the institutional shareholders can play in the corporate governance system of a company. "... in view of the Committee is that, the institutional shareholders put to good use their voting power... ". These reports raise one interesting question that must be answered before we can comment on the role that the institutional investors should play in the corporate governance system of a company. Institutional investors are answerable to their investors the way the companies (in which they have invested) are answerable to their shareholders. And the shareholders do invest their funds with the institutional investors expecting higher returns. The primary responsibility of the institutional investors is therefore to invest the money of the investors in companies, which are expected to generate the maximum possible return rather than in companies with good corporate governance records. Most of the Corporate Governance reports ignore this aspect when they expect the institutional investors to play the role of an active investor\footnote{http://nseiindia.com/content/research/Paper42.pdf (Institutional Investors and Corporate Governance in India, by Pitabas Mohanty)}.

The Pros and Cons on the role of the institutional investors in promoting the good corporate governance may be listed as under:

<table>
<thead>
<tr>
<th>Pros</th>
<th>Cons</th>
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<tbody>
<tr>
<td>The institutional investors have significant stakes in the companies and so of the voting power.</td>
<td>Mutual Fund Investors have the short term vision hence their performance measurement may not be a significant evaluation in assessing the corporate governance while making the investment decision.</td>
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</tbody>
</table>
They are in better position to have the access of the information about the company.

The investment objectives are also a deciding factor while making the investment decision.

The stock market performance can visualised with the adoption of the better corporate governance.

Institutional investors may off load the holding if there is mis-matching in their asset-liability / liquidity position.

They may influence in attracting the Foreign Direct Investment in India.

A common man's investment portfolio is effected with the decision of the investment by the institutional investors.

Based on the experience of countries where shareholders activism is vibrant, such as for example Australia, France, the UK, or the United States, it is reasonable to expect that Indian institutional investor should use their ownership rights more actively.

Findings of the World Bank suggests that Indian institutional investors seldom review the agenda of shareholders meetings, do not attend shareholders meetings, and do not exercise their voting rights, unless something goes drastically wrong, or if a takeover situation occurs. Nor do they disclose their voting records. Foreign institutional investors tend to exercise their ownership rights more actively.

**World Bank Recommendation**

**Policy Recommendation # 1**: Based on discussions with policy makers, market regulators and market participants, and taking into account the current topology of India's institutional investment community, a least cost, voluntary approach to compliance with OECD Principle 1.G seems most appropriate for India, at least for the next few years. Such an approach would introduce “soft” incentives for institutional investors to differentiate themselves from each other and leave market forces to drive the process. It is therefore recommended that the Securities and Exchange Board of India for mutual funds and FIIs, and the Insurance Regulatory and Development Authority for insurance companies, and the Pension Fund Regulatory and Development Authority for pension funds (when these are set up) issue some guidelines, on a stand alone basis or as part of their code of conduct as appropriate, recommending that the institutions that fall under their oversight, should disclose to the market, on a comply or explain basis, via their company website, their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights. It should also be recommended that these institutions post annually on the same website, their voting records, on an ex-post basis.

**OECD Principles**

Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.

**ICSI Recommendation 23**: It should be mandatory for institutional investors to disclose as to how they manage material conflicts of interests that may affect the exercise of key ownership rights regarding their investments. The disclosure should be made in the prospectuses and periodic financial statements of the mutual funds.

Over the last decade and a half, market forces have driven Indian financial services companies to seek critical mass. Large financial conglomerates have been created that include insurance companies, commercial banks, investment banks, non banks financial institutions, and mutual funds. Whilst this
transformation has created vast synergies, and made the groups more competitive, it has also created potential conflicts of interests between a group’s fiduciary institution and its other components.

**World Bank Recommendation**

Policy Recommendation 2: In line with international best practice, the Securities and Exchange Board of India for Mutual Funds and the Insurance Regulatory and Development Authority for Insurance Companies should mandate the disclosure by institutions under their oversights of how they manage material conflicts of interests that may affect the exercise of key ownership rights regarding their investments. More generally such disclosure should extend to all institutional investors acting in a fiduciary capacity. The disclosure should be made in the prospectuses and in the periodic financial statements.

**OECD Principles**

Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

**ICSI Recommendation 24:** A directive be issued to clarify the nature of the information that can be exchanged at meetings between institutional investors and companies, in compliance with the Insider Trading Regulations of 1992 and its 2002 amendment. The directive should stress that it does not condone the selective disclosure of information by companies to institutions and clearly set the principle of equality of treatment of all shareholders by corporations.

**World Bank Recommendation**

SEBI should issue a directive to clarify the nature of the information that can be exchanged at meetings between institutional investors and companies, in compliance with the Insider Trading Regulations of 1992 and its 2002 amendment. The directive should stress that it does not condone the selective disclosure of information by companies to institutions and clearly set the principle of equality of treatment of all shareholders by corporations.

SEBI vide circular dated 24th March, 2014 had in order to improve transparency as well as encourage Mutual Funds/AMCs to diligently exercise their voting rights in best interest of the unit-holders, has been decided that:

a. AMCs shall be required to record and disclose specific rationale supporting their voting decision (for, against or abstain) with respect to each vote proposal.

b. AMCs shall additionally be required to publish summary of the votes cast across all its investee company and its break-up in terms of total number of votes cast in favor, against or abstained from.

c. AMCs shall be required to make disclosure of votes cast on their website (in spreadsheet format) on a quarterly basis, within 10 working days from the end of the quarter. Further, AMCs shall continue disclosing voting details in their annual report.

d. Further, on an annual basis, AMCs shall be required to obtain Auditor’s certification on the voting reports being disclosed by them.

**Institutional Investors – Global Trends**

**The UK 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 which

the ISC converted to a code in 2009. Following the 2009 Walker Review of governance in financial institutions, the FRC was invited to take responsibility for the Code. In 2010, the FRC published the first version of the UK Stewardship Code, which closely mirrored the ISC code. This edition of the Code does not change the spirit of the 2010 Code.

1. Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole.

2. In publicly listed companies responsibility for stewardship is shared. The primary responsibility rests with the board of the company, which oversees the actions of its management. Investors in the company also play an important role in holding the board to account for the fulfilment of its responsibilities.

3. The UK Corporate Governance Code identifies the principles that underlie an effective board. The UK Stewardship Code sets out the principles of effective stewardship by investors. In so doing, the Code assists institutional investors better to exercise their stewardship responsibilities, which in turn gives force to the “comply or explain” system.

4. For investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings.

5. Institutional investors’ activities include decision-making on matters such as allocating assets, awarding investment mandates, designing investment strategies, and buying or selling specific securities. The division of duties within and between institutions may span a spectrum, such that some may be considered asset owners and others asset managers.

6. Broadly speaking, asset owners include pension funds, insurance companies, investment trusts and other collective investment vehicles. As the providers of capital, they set the tone for stewardship and may influence behavioural changes that lead to better stewardship by asset managers and companies. Asset managers, with day-to-day responsibility for managing investments, are well positioned to influence companies’ long-term performance through stewardship.

7. Compliance with the Code does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding, where this is considered in the best interest of clients or beneficiaries.

Seven Principles:

Principle 1- Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

Guidance

- Stewardship activities include monitoring and engaging with companies on matters such as strategy,
- performance, risk, capital structure, and corporate governance, including culture and remuneration.
- Engagement is purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meetings.
• The policy should disclose how the institutional investor applies stewardship with the aim of enhancing and protecting the value for the ultimate beneficiary or client.

• The statement should reflect the institutional investor’s activities within the investment chain, as well as the responsibilities that arise from those activities.

• In particular, the stewardship responsibilities of those whose primary activities are related to asset ownership may be different from those whose primary activities are related to asset management or other investment-related services.

• Where activities are outsourced, the statement should explain how this is compatible with the proper exercise of the institutional investor’s stewardship responsibilities and what steps the investor has taken to ensure that they are carried out in a manner consistent with the approach to stewardship set out in the statement.

• The disclosure should describe arrangements for integrating stewardship within the wider investment process.

Principle 2- Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.

Guidance

• An institutional investor’s duty is to act in the interests of its clients and/or beneficiaries.

• Conflicts of interest will inevitably arise from time to time, which may include when voting on matters affecting a parent company or client.

• Institutional investors should put in place, maintain and publicly disclose a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of their client or beneficiary first.

• The policy should also address how matters are handled when the interests of clients or beneficiaries diverge from each other.

Principle 3- Institutional investors should monitor their investee companies.

Guidance: Effective monitoring is an essential component of stewardship. It should take place regularly and be checked periodically for effectiveness.

• When monitoring companies, institutional investors should seek to: keep abreast of the company’s performance; keep abreast of developments, both internal and external to the company, that drive the company’s value and risks; satisfy themselves that the company’s leadership is effective; satisfy themselves that the company’s board and committees adhere to the spirit of the; UK Corporate Governance Code, including through meetings with the chairman and other board members; consider the quality of the company’s reporting; and attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.

• Institutional investors should consider carefully explanations given for departure from the UK Corporate Governance Code and make reasoned judgements in each case.

• They should give a timely explanation to the company, in writing where appropriate, and be prepared to enter a dialogue if they do not accept the company’s position.

• Institutional investors should endeavour to identify at an early stage issues that may result in a significant loss in investment value.
• If they have concerns, they should seek to ensure that the appropriate members of the investee company’s board or management are made aware.

• Institutional investors may or may not wish to be made insiders. An institutional investor who may be willing to become an insider should indicate in its stewardship statement the willingness to do so, and the mechanism by which this could be done.

• Institutional investors will expect investee companies and their advisers to ensure that information that could affect their ability to deal in the shares of the company concerned is not conveyed to them without their prior agreement.

Principle 4 - Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

Guidance:

Institutional investors should set out the circumstances in which they will actively intervene and regularly assess the outcomes of doing so. Intervention should be considered regardless of whether an active or passive investment policy is followed. In addition, being underweight is not, of itself, a reason for not intervening. Instances when institutional investors may want to intervene include, but are not limited to, when they have concerns about the company’s strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matters. Initial discussions should take place on a confidential basis. However, if companies do not respond constructively when institutional investors intervene, then institutional investors should consider whether to escalate their action, for example, by:

• holding additional meetings with management specifically to discuss concerns;
• expressing concerns through the company’s advisers;
• meeting with the chairman or other board members;
• intervening jointly with other institutions on particular issues;
• making a public statement in advance of General Meetings;
• submitting resolutions and speaking at General Meetings; and
• requisitioning a General Meeting, in some cases proposing to change board membership.

Principle 5 - Institutional investors should be willing to act collectively with other investors where appropriate.

Guidance:

At times collaboration with other investors may be the most effective manner in which to engage. Collective engagement may be most appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten to destroy significant value.

Institutional investors should disclose their policy on collective engagement, which should indicate their readiness to work with other investors through formal and informal groups when this is necessary to achieve their objectives and ensure companies are aware of concerns. The disclosure should also indicate the kinds of circumstances in which the institutional investor would consider participating in collective engagement.

Principle 6 - Institutional investors should have a clear policy on voting and disclosure of voting activity.
Guidance:
Institutional investors should seek to vote all shares held. They should not automatically support the board. If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution. In both instances, it is good practice to inform the company in advance of their intention and the reasons why.

Institutional investors should disclose publicly voting records. Institutional investors should disclose the use made, if any, of proxy voting or other voting advisory services. They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services. Institutional investors should disclose their approach to stock lending and recalling lent stock.

Principle 7- Institutional investors should report periodically on their stewardship and voting activities.

Guidance:
Institutional investors should maintain a clear record of their stewardship activities. Asset managers should regularly account to their clients or beneficiaries as to how they have discharged their responsibilities. Such reports will be likely to comprise qualitative as well as quantitative information. The particular information reported and the format used, should be a matter for agreement between agents and their principals. Asset owners should report at least annually to those to whom they are accountable on their stewardship policy and its execution.

Transparency is an important feature of effective stewardship. Institutional investors should not, however, be expected to make disclosures that might be counterproductive. Confidentiality in specific situations may well be crucial to achieving a positive outcome.

Asset managers that sign up to this Code should obtain an independent opinion on their engagement and voting processes having regard to an international standard or a UK framework such as AAF 01/062. The existence of such assurance reporting should be publicly disclosed. If requested, clients should be provided access to such assurance reports.

Principles for Responsible Investment (PRI)

The United Nations-supported Principles for Responsible Investment (PRI) Initiative is an international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices.

In implementing the Principles, signatories contribute to the development of a more sustainable global financial system.

The Principles are voluntary and aspirational. They offer a menu of possible actions for incorporating ESG issues into investment practices across asset classes. Responsible investment is a process that must be tailored to fit each organisation’s investment strategy, approach and resources. The Principles are designed to be compatible with the investment styles of large, diversified, institutional investors that operate within a traditional fiduciary framework.

The PRI Initiative has quickly become the leading global network for investors to publicly demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices.
If you have suggestions on the PRI work plan or strategy that you would like us to hear about, you can email them to suggestions@unpri.org. We will review your suggestions and respond accordingly.

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; fostering good governance, integrity and accountability; and addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

**The six Principles**

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

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

Possible actions:

- Address ESG issues in investment policy statements
- Support development of ESG-related tools, metrics, and analyses
- Assess the capabilities of internal investment managers to incorporate ESG issues
- Assess the capabilities of external investment managers to incorporate ESG issues
- Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis
- Encourage academic and other research on this theme
- Advocate ESG training for investment professionals

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

Possible actions:

- Develop and disclose an active ownership policy consistent with the Principles
- Exercise voting rights or monitor compliance with voting policy (if outsourced)
- Develop an engagement capability (either directly or through outsourcing)
- Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights)
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- File shareholder resolutions consistent with long-term ESG considerations
- Engage with companies on ESG issues
- Participate in collaborative engagement initiatives
- Ask investment managers to undertake and report on ESG-related engagement

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

Possible actions:
- Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative)
- Ask for ESG issues to be integrated within annual financial reports
- Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact)
- Support shareholder initiatives and resolutions promoting ESG disclosure

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

Possible actions:
- Include Principles-related requirements in requests for proposals (RFPs)
- Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate)
- Communicate ESG expectations to investment service providers
- Revisit relationships with service providers that fail to meet ESG expectations
- Support the development of tools for benchmarking ESG integration
- Support regulatory or policy developments that enable implementation of the Principles

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

Possible actions:
- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning
- Collectively address relevant emerging issues
- Develop or support appropriate collaborative initiatives

**Principle 6: We will each report on our activities and progress towards implementing the Principles.**

Possible actions:
- Disclose how ESG issues are integrated within investment practices
- Disclose active ownership activities (voting, engagement, and/or policy dialogue)
- Disclose what is required from service providers in relation to the Principles
• Communicate with beneficiaries about ESG issues and the Principles
• Report on progress and/or achievements relating to the Principles using a *Comply or Explain* approach
• Seek to determine the impact of the Principles
• Make use of reporting to raise awareness among a broader group of stakeholders

* The Comply or Explain approach requires signatories to report on how they implement the Principles, or provide an explanation where they do not comply with them.

The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. The process was convened by the United Nations Secretary-General.

In signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society.

We encourage other investors to adopt the Principles.

**Code for Responsible Investing in South Africa (CRISA)**

The Code for Responsible Investing in South Africa (CRISA) gives guidance on how the institutional investor should execute investment analysis and investment activities and exercise rights so as to promote sound governance.

**CRISA applies to:**

• Institutional investors as asset owners, for example, pension funds and insurance companies.
• Service providers of institutional investors, for example, asset and fund managers and consultants.

Introduction: A non-mandatory market-based code of governance, such as the King Code, is (in the context of listed companies) stronger if its implementation is overseen by those with a vested interest in effective market forces i.e. the institutional investor. The institutional investor has by virtue of its share ownership and rights, including voting rights, the ability to influence and encourage investee companies to apply sound governance principles and practices. Recent experience in South Africa and internationally indicates that market failures in relation to governance are, at least in part, due to an absence of active institutional investors, or investment behaviour driven by short-term results.

In reaction to comments on the King Report which were submitted by the South African PRI network and which called for guidance to the investor community to be included in the Report, the King Committee recommended that a separate code be drafted to specifically set out the expectations from institutional investors in this regard. The Committee on Responsible Investing by Institutional Investors in South Africa has been convened by the IoDSA to develop such a code.

**Purpose:** The King Code was written from the perspective of the board of the company as the focal point of corporate governance. CRISA is intended to give guidance on how the institutional investor should execute investment analysis and investment activities and exercise rights so as to promote sound governance. Read together, the King Code and CRISA provide a framework that relates to the function of all role players in the overall governance system, including boards of companies, institutional shareholders, their service providers
and the ultimate beneficiaries. The objective of providing such a framework is to ensure that sound governance is practised which results in better performing companies that deliver both economic value as well as value within its broader meaning.

**Application:** Legally, the institutional investor, who is the asset owner, has fiduciary duties towards the ultimate beneficiaries of these investments and is accountable in this regard. If an institutional investor appoints a service provider, to make investment decisions or to execute any aspect of the investment activities dealt within CRISA, that relationship is regulated by the mandate between the asset owner and service provider. Expectations for application of CRISA’s reporting requirements and sanctions for non-adherence by the service provider are to be agreed and determined via this mandate. However, the accountability of the institutional investor to the ultimate beneficiary is not diminished by such mandate. In addition, to the institutional investor, the pivotal role of service providers in promoting sound governance cannot be disregarded and it is intended that the principles and practice recommendations contained in CRISA also apply to service providers and the manner in which they execute their mandates. Therefore where CRISA makes recommendations that pertain to investment decisions or investment activities that fall within the ambit of the mandate, the service provider should follow such recommendations even if the recommendation makes reference to the institutional investor only. The approach that CRISA applies to both the institutional investor and its service providers, but that the institutional investor bears accountability to ultimate beneficiaries, has been followed throughout this document. As the purpose of CRISA is to form part of an effective governance framework in South Africa, it is furthermore proposed that foreign pension funds, insurance companies, investment trusts and other collective investment vehicles apply CRISA to the extent that they invest in South African companies. Institutional investors and service providers should adopt the principles and practice recommendations in CRISA on an “apply or explain” basis. Where there is conflict between CRISA and applicable legislation, the legislation will prevail. The effective date for reporting on the application of CRISA is 1 February 2012.

**Five Principles:**

**Principle 1:** An institutional investor should incorporate sustainability considerations, including ESG, into its investment analysis and investment activities as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries.

1. An institutional investor should develop a policy on how it incorporates sustainability considerations, including ESG, into its investment analysis and activities. The matters to be dealt with in the policy should include, but not necessarily be limited to, an assessment of: a. the sum of tangible and intangible assets of a company; b. the quality of the company’s integrated reporting dealing with the long-term sustainability of the company’s strategy and operations. If integrated reporting has not been applied, due enquiry should be made on the reasons for this; c. the manner in which the business of the company is being conducted based on, for example, alignment with targeted investment strategies of the institutional investor and the code of conduct and supply chain code of conduct of the company.

2. An institutional investor should ensure implementation of the policy on sustainability considerations, including ESG, and establish processes to monitor compliance with the policy.

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

3. An institutional investor should develop a policy dealing with ownership responsibilities. The policy should include, but not necessarily be limited to the following: a. guidelines to be applied (e.g. King
III) for the identification of sustainability concerns, including ESG, at a company.

b. mechanisms of intervention and engagement with the company when concerns have been identified and the means of escalation of activities as a shareholder if these concerns cannot be resolved. c. voting at shareholder meetings, including the criteria that are used to reach voting decisions and for public disclosure of full voting records

4. Even if passive investment strategies are followed, active voting policies incorporating sustainability considerations, including ESG, should still be followed.

5. An institutional investor should ensure implementation of the policy on ownership responsibilities and establish processes to monitor compliance with the policy.

6. Where the institutional investor outsources to third party service providers, the onus is on the institutional investor as owner to ensure that the mandate deals with sustainability concerns, including ESG, and that there are processes to oversee that the service providers apply the provisions of CRISA when executing their mandate.

7. The institutional investor should introduce controls that prevent it from receiving price sensitive information regarding a company or acting on such information in a manner that makes it an ‘insider’ in terms of the Securities Services Act No 36 of 2004. These controls should be applied when engaging with the company, and when seeking any information it requires, whether this is to fulfill its duties or to act within the guidelines of CRISA.

Principle 3: Where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the principles of CRISA and other codes and standards applicable to institutional investors.

8. An institutional investor should consider a collaborative approach to work jointly with other shareholders, service providers, regulators, investee companies and ultimate beneficiaries to, where appropriate, promote acceptance and implementation of CRISA and sound governance. Parties should be aware of the consequences of acting in concert in terms of applicable legislation.

Principle 4: An institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should pro-actively manage these when they occur.

9. All of the circumstances and relationships that could potentially lead to a conflict of interest should be identified by the institutional investor and a policy for preventing and managing these conflicts should be developed.

10. An institutional investor should ensure implementation of the policy on prevention and management of conflicts of interests and establish processes to monitor compliance with this policy.

Principle 5: Institutional investors should be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments.

11. An institutional investor should regularly engage with its stakeholder groupings, including investee companies and the ultimate beneficiaries, in order to, inter alia, identify and understand information requirements and, at least once a year, fully and publicly disclose to what extent it applies to CRISA.

12. If an institutional investor does not apply some or any of the principles or recommendations in CRISA or applies them differently from how they are set out, it should in a transparent manner explain the reasons for this and the alternative measures employed.
13. The disclosure by institutional investors should be made public in order that it is readily accessible by all stakeholders, including investee companies and the ultimate beneficiaries.

14. The following policies should be disclosed publicly upon CRISA becoming effective and subsequently in the event of changes to the policies: a. policy on incorporation of sustainability considerations, including ESG, into investment analysis and investment activities with reference to the matters as set out under Principle 1. b. policy in regard to ownership responsibilities, including voting as set out under Principle 2. c. policy on identification, prevention and management of conflicts of interests as set out under Principle 4.

15. Non-disclosure of voting records by an institutional investor and its service providers precludes the investee company the opportunity to engage with the institutional investor or its service providers regarding the vote exercised. Therefore an institutional investor and its service providers should, before agreeing to a proxy or other instruction to keep voting records confidential, carefully consider the reasons put forward to justify confidentiality.

16. Disclosure of policies should be reinforced by clear explanation of how the commitments made in the policies were practically implemented and monitored during the reporting period.

17. There should be disclosure by an institutional investor of processes to ensure that its service providers apply CRISA as well as the requirements of the institutional investor’s policies.

California Public Employees’ Retirement System (Updated March 16, 2015)

The California Public Employees’ Retirement System (CalPERS, System) is the largest U.S. public pension fund, with assets totaling approximately $300 billion spanning domestic and international markets as of June 30, 2014. Its mission is to provide responsible and efficient stewardship of the System to deliver promised retirement and health benefits, while promoting wellness and retirement security for members and beneficiaries. This mission was adopted by the CalPERS Board of Administration in serving more than 1.6 million members and retirees.

The CalPERS Board of Administration is guided by the CalPERS Board’s Investment Committee, Investment Beliefs1 and Core Values: Quality, Respect, Accountability, Integrity, Openness, and Balance. CalPERS management and more than 380 Investment Office staff carry out the daily activities of the investment program. Our goal is to efficiently and effectively manage investments to achieve the highest possible return at an acceptable level of risk. In doing so, CalPERS has generated strong long-term returns.

CalPERS Global Governance Program has evolved since the mid-80’s when it was solely reactionary: reacting to the anti-takeover actions of corporate managers that struck a dissonant chord with owners of the corporate entity concerned with accountability and fair play. The late 1980s and early 1990s represented a period in which CalPERS learned a great deal about the “rules of the game” – how to influence corporate managers, what issues were likely to elicit fellow shareowner support, and where the traditional modes of shareowner/corporation communication were at odds with current reality. Beginning in 1993, CalPERS turned its focus toward companies considered by virtually every measure to be “poor” financial performers. By centering its attention and resources in this way, CalPERS could demonstrate very specific and tangible results to those who questioned the value of corporate governance.

In 2011, CalPERS Global Governance Program transitioned into an Investment Office-wide role to support the Total Fund; and, the CalPERS Board approved the adoption of a Total Fund process for integrating environmental, social, and governance (ESG) issues across the investment portfolio as a strategic priority. This transition recognizes CalPERS’ ongoing effort3 to integrate ESG factors into
investment decision making across asset classes, grounded in the three forms of economic capital — financial, human, and physical — that are needed for long-term value creation. This work has also been integrated into CalPERS Investment Beliefs which address sustainable investment, risk management, and CalPERS engagement with companies, regulators, managers, and stakeholders.

The CalPERS Board, through its Investment Committee, has adopted the Global Governance Principles (Global Principles). The Global Principles create the framework by which CalPERS:

1. Executes its shareowner proxy voting responsibilities.
2. Engages investee companies to achieve long-term sustainable risk-adjusted returns.
3. Requests internal and external managers of CalPERS capital to take into consideration when making investment decisions.

The Global Principles are broken down into three areas — Core, Domestic, and International Principles. Adopting the Global Principles in its entirety may not be appropriate for every company in the global capital marketplace due to differing developmental stages, competitive environment, regulatory or legal constraints. However, CalPERS does believe the criteria contained in the Core Principles should be adopted by companies across all markets - from developed to emerging – in order to establish the foundation for achieving long-term sustainable investment returns through accountable corporate governance structures.

For companies in the United States or listed on U.S. stock exchanges, CalPERS advocates the expansion of the Core Principles into the Domestic Principles. For companies outside the United States or listed on non-U.S. stock exchanges, CalPERS advocates the expansion of the Core Principles into the International Principles.

CalPERS expects all internal and external managers of CalPERS capital to integrate the Global Principles into investment decision making including proxy voting, consistent with fiduciary duty. CalPERS recognizes that countries and companies are in different developmental stages and that CalPERS investment managers will need to exercise their best judgment after taking all relevant factors, principles, and trends into account. CalPERS requires internal and external managers across the total fund to consider these Global Principles among the decision factors employed in the investment process.

Principles:

There are many features that are important considerations in the continuing evolution of corporate governance best practices. However, the underlying tenet for CalPERS Core Principles is that fully accountable governance structures produce, over the long term, the best returns to shareowners. CalPERS believes the following Core Principles should be adopted by companies and markets – from developed to emerging – in order to establish the foundation for achieving long-term sustainable investment returns through accountable corporate governance structures.

1. **Sustainability**: Companies and external managers in which CalPERS invests are expected to optimize operating performance, profitability and investment returns in a risk-aware manner while conducting themselves with propriety and with a view toward responsible conduct. Anchored by CalPERS Investment Beliefs, CalPERS believes long-term value creation requires the effective management of three forms of capital described as follows:

   a. **Financial Capital (Governance)**: Governance is the primary tool to align interests between CalPERS and the managers of our financial capital – including companies and external managers. Good governance enhances a company’s long-term value and protects investor interests.
b. **Physical Capital (Environment):** Encouraging external managers, portfolio companies, and policy makers to engage in responsible environmental practices is important to identifying opportunities and risk management. This means making wise use of scarce resources, considering impact, and addressing systemic risks, such as climate change.

c. **Human Capital (Social):** The success and long-term value of the companies we invest in will be impacted by their management of human capital. This includes fair labor practices, responsible contracting, workplace and board diversity, and protecting the safety of employees directly and through the supply chain.

2. **Director Accountability:** Directors should be accountable to shareowners, and management accountable to directors. To ensure this accountability, directors must be accessible to shareowner inquiry concerning their key decisions affecting the company’s strategic direction.

3. **Transparency:** Operating, financial, and governance information about companies must be readily transparent to permit accurate market comparisons; this includes disclosure and transparency of objective globally accepted minimum accounting standards, such as the International Financial Reporting Standards (“IFRS”).

4. **One-share/One-vote:** All investors must be treated equitably and upon the principle of one-share/one-vote.

5. **Proxy Materials:** Proxy materials should be written in a manner designed to provide shareowners with the information necessary to make informed voting decisions. Similarly, proxy materials should be distributed in a manner designed to encourage shareowner participation. All shareowner votes, whether cast in person or by proxy, should be formally counted with vote outcomes formally announced.

6. **Code of Best Practices:** Each capital market in which shares are issued and traded should adopt its own Code of Best Practices to promote transparency of information, prevention of harmful labor practices, investor protection, and corporate social responsibility. Where such a code is adopted, companies should disclose to their shareowners whether they are in compliance.

7. **Long-term Vision:** Corporate directors and management should have a long-term strategic vision that, at its core, emphasizes sustained shareowner value and effective management of both risk and opportunities in the oversight of financial, physical, and human capital. In turn, despite differing investment strategies and tactics, shareowners should encourage corporate management to resist short-term behavior by supporting and rewarding long-term superior returns.

8. **Access to Director Nominations:** Shareowners should have effective access to the director nomination process.

9. **Political Stability:** Progress toward the development of basic democratic institutions and principles, including such things as: a strong and impartial legal system; and, respect and enforcement of property and shareowner rights.

**Political stability encompasses:**

a. Political risk: internal and external conflict; corruption; the military and religion in politics; law and order; ethnic tensions; democratic accountability; bureaucratic quality.

b. Civil liberties: freedom of expression, association and organization rights; rule of law and human rights; free trade unions and effective collective bargaining; personal autonomy and economic rights.
c. Independent judiciary and legal protection: an absence of irregular payments made to the judiciary; the extent to which there is a trusted legal framework that honors contracts, clearly delineates ownership and protects financial assets.

10. Transparency: Financial transparency, including elements of a free press, is necessary for investors to have truthful, accurate and relevant information.

Transparency encompasses:

a. Freedom of the press: structure of the news delivery system in a country; laws and their promulgation with respect to the influence of the news; the degree of political influence and control; economic influences on the news; the degree to which there are violations against the media with respect to physical violations and censorship.

b. Monetary and fiscal transparency: the extent to which governmental monetary and fiscal policies and implementation are publicly available in a clear and timely manner, in accordance with international standards.

c. Stock exchange listing requirements: stringency of stock exchange listing requirements with respect to frequency of financial reporting, the requirement of annual independent audits, and minimal financial viability.

d. Accounting standards: the extent to which U.S. Generally Accepted Accounting Principles, or International Accounting Standards is used in financial reporting; whether the country is a member of the International Accounting Standards Council.

11. Productive Labor Practices: No harmful labor practices or use of child labor. In compliance, or moving toward compliance, with the International Labor Organization (ILO) Declaration on the Fundamental Principles and Rights at Work.

Productive Labor Practices encompasses:

a. ILO ratification: whether the convention is ratified, not ratified, pending ratification or denounced.

b. Quality of enabling legislation: the extent to which the rights described in the ILO convention are protected by law.

c. Institutional capacity: the extent to which governmental administrative bodies with labor law enforcement responsibility exist at the national, regional and local level.

d. Effectiveness of implementation: evidence that enforcement procedures exist and are working effectively; evidence of a clear grievance process that is utilized and provides penalties that have deterrence value.

12. Corporate Social Responsibility – Eliminating Human Rights Violations: Corporations should adopt maximum progressive practices toward the elimination of human rights violations in all countries or environments in which the company operates. Additionally, these practices should emphasize and focus on preventing discrimination and/or violence based on race, color, religion, national origin, age, disability, sexual orientation, gender identity, marital status, or any other status protected by laws or regulations in areas of a company’s operation.

Companies should operate in compliance, or moving toward compliance, with the Global Sullivan Principles (Appendix B), or the human rights and labor standards principles exemplified by the United Nations Global Compact Principles.

Market regulation and liquidity encompasses:

a. Market capitalization
b. Change in market capitalization
c. Average monthly trading volume
d. Growth in listed securities
e. Market volatility as measured by standard deviation
f. Return/risk ratio


Capital market openness encompasses:

a. Foreign investment: degree to which there are restrictions on foreign ownership of local assets, repatriation restrictions or un-equal treatment of foreigners and locals under the law.
b. Trade policy: degree to which there are deterrents to free trade such as trade barriers and punitive tariffs.
c. Banking and finance: degree of government ownership of banks and allocation of credit; freedom financial institutions have to offer all types of financial services; protectionist banking regulations against foreigners.

15. Settlement Proficiency/Transaction Costs: Reasonable trading and settlement proficiency and reasonable transaction costs.

Settlement proficiency/transaction costs encompass:

a. Trading and settlement proficiency: degree to which a country's trading and settlement is automated; success of the market in settling transactions in a timely, efficient manner.
b. Transaction costs: the costs associated with trading in a particular market, including stamp taxes and duties; amount of dividends and income taxes; capital gains taxes.

16. Disclosure: Companies should adopt corporate reporting guidelines in order to measure, disclose, and be accountable to internal and external stakeholders for organizational performance. Disclosure reporting guidelines should include:

a. The effect of environmental, social and governance impacts, risks and opportunities related to the company's stakeholders.
b. Activities the company is undertaking to protect shareowner rights and investment capital.

17. Financial Markets: Policy makers and standards setters which impact investment portfolio risk and return should promote fair, orderly, and effectively regulated financial markets through the following:

a. Transparency: To promote full disclosure so that the financial markets provide incentives that price risk and opportunity.
b. Governance: To foster alignment of interest, protect investor rights and independence of
regulators.

c. **Systemic Risk:** For earlier identification by regulators of issues that give rise to overall market risk that threaten global markets and foster action that mitigates those risks.

## Tools used by Institutional Investors

The Institutional Investors use different tools to assess the health of Company before investing resources in it. Some of the important tools are discussed as under:

**One-to-one meetings:** The meetings between institutional investors and companies are extremely important as a means of communication between the two parties. This is one clear example of the way that individual investors are at a disadvantage to institutional investors as corporate management will usually only arrange such meetings with large investors who are overwhelmingly institutional investors. A company will usually arrange to meet with its largest institutional investors on a one-to-one basis during the course of the year.

**Voting:** The right to vote which is attached to voting shares (as opposed to non-voting shares) is a basic prerogative of share ownership, and is particularly important given the division of ownership (shareholders) and control (directors) in the modern corporation. The right to vote can be seen as fundamental tools for some element of control by shareholders. The institutional investors can register their views by postal voting, or, vote electronically where this facility is available. Most of the large institutional investors now have a policy of trying to vote on all issues which may be raised at their investee company's AGM. Some may vote directly on all resolutions, others may appoint a proxy (which may be a board member). Generally, an institutional investor will try to sort out any contentious issues with management ‘behind the scenes’, however if this fails, then they may abstain from voting on a particular issue (rather than voting with incumbent management as they generally would) or they may actually vote against a resolution. In this case, they would generally inform the firm of their intention to vote against. Corporate governance issues tend to be the most contentious, particularly directors’ remuneration and lengths of contract.

**Focus lists:** A number of institutional investors have established ‘focus lists’ whereby they target underperforming companies and include them on a list of companies which have underperformed a main index, such as Standard and Poor’s. Under performing index would be a first point of identification, other factors would include not responding appropriately to the institutional investor’s inquiries regarding underperformance, and not taking account of the institutional investor’s views. After being put on the focus list, the companies often receive unwanted, attention of the institutional investors who may seek to change various directors on the board.

**Corporate governance rating systems:** With the increasing emphasis on corporate governance across the globe, it is perhaps not surprising that a number of corporate governance rating systems have been developed. Examples of such firms which have developed corporate governance rating systems are Deminor, Standard and Poor’s, and Governance Metrics International (GMI). The rating system cover several markets, for example, Deminor has tended to concentrate on European companies whilst Standard and Poor’s have used their corporate governance rating system in quite different markets, for example, Russia. GMI ratings cover a range of countries including the US, various countries in the Asia-Pacific region and Europe. These corporate governance rating systems should be of benefit to investors, both potential and those presently invested, and to the companies themselves.

In turn, the ratings will also be useful to governments in identifying perceived levels of corporate governance in their country compared to other countries in their region, or outside it, whose companies may be competing for limited foreign investment. In emerging market countries in particular, those companies with a corporate governance infrastructure will, ceteris paribus, be less subject to cronyism
and its attendant effects on corporate wealth. These companies would tend to be more transparent and accountable, and hence more attractive to foreign investors.

A corporate governance rating could be a powerful indicator of the extent to which a company currently is adding, or has the potential to add in the future, shareholder value. This is because a company with good corporate governance is generally perceived as more attractive to investors than one without. Good corporate governance should, for example, indicate a board that is prepared to participate actively in dialogue with its shareholders, ensuring the effective exercise of voice (Hirschman 1970) thus enabling investors to articulate their interests.

**Conclusion**

Shareholders are one of the most important stakeholders of a corporate. Upholding the legitimate rights of the shareholders, equitable treatment amongst all shareholders, meaningful engagement with them, etc. are all paramount in ensuring good corporate governance. Protection of shareholder rights is the fundamental expectation from any corporate.

**LESSONS ROUND UP:**

- Protection of shareholder rights is sacrosanct for good corporate governance. It is one of the pillars of corporate governance.
- In India, the SEBI Act, 1992, the various SEBI Regulations/Guidelines and the Companies Act, 2013 enables the empowerment of shareholder rights.
- Any member of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members may apply to the Tribunal for an order.
- Shareholder has right to pass a special resolution, resolving that the company be wound up by the Tribunal.
- Principle III of the OECD Principles on Corporate Governance states that the corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders.
- Investor Education and Protection Fund (IEPF) has been established under Section 125 of the Companies Act, 2013 for promotion of investors’ awareness and protection of the interests of investors.
- The audit committee has an important role in monitoring related party transactions. In most jurisdictions the first level monitoring of the related party transactions is done by the audit committee.
- Independent judgment is critical to monitoring related party transactions and to ensure that agreed transactions are in the interests of the company and all shareholders.
- The Company shall disclose in its Corporate Governance Report, about the whistle Blower policy and affirmation that no personnel has been denied access to the audit committee.
- Shareholder activism refers to the active involvement of stockholders in their organization. Shareholders can ensure that the company follows good corporate governance practices and implements beneficial policies.
- Investor Relations (IR) is a strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between a company, the financial community, and other constituencies, which ultimately contributes to a company’s securities achieving fair valuation.
- The Sarbanes-Oxley Act significantly increased the importance of investor relations in the financial markets.
- Institutional investors are organizations which pool large sums of money and invest those sums in companies. Their role in the economy is to act as highly specialized investors on behalf of others.
- UK Stewardship Code (2012) aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities.
- As a strategy CalPERS invest in sick and ailing companies where it employs good governance practices to improvise company’s overall performance.
- The Institutional Investors use different tools like One-to-one meetings, focus lists, Corporate governance rating systems, etc. to assess the health of Company before investing resources in it.

### SELF TEST QUESTIONS

1. Discuss about the challenges in exercising shareholder rights?
2. What are the tools that an institutional investor can use to assess the health of a company?
3. Discuss the major principles of UK Stewardship code?
4. Who is insider? What is meant by insider trading?
5. What do you understand by shareholder activism?
Lesson 8
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
• 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.
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.²

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.³

R. Edward Freeman's view on Stakeholder Theory⁴: 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 Freeman⁵, 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)

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³ [http://www.businessdictionary.com/definition/stakeholder-theory.html](http://www.businessdictionary.com/definition/stakeholder-theory.html)
⁵ 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.
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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**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) **Schedule IV Code of Independent Directors: Para II. Role and Functions:**

The independent directors shall:

1. safeguard the interests of all stakeholders, particularly the minority shareholders;
2. 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:-

1. The listed entity should respect the rights of stakeholders that are established by law or through mutual agreements.
2. Stakeholders should have the opportunity to obtain effective redress for violation of their rights.
3. 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.
4. The listed entity should devise an effective whistle blower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

**Stakeholder Engagement**

Stakeholder engagement is the process by which an organisation involves people who may be affected by the decisions it makes or can influence the implementation of its decisions. It is an alliance-building tool. Corporations practice stakeholder engagement in an effort to understand the needs of their stakeholders, create partnerships and to promote dialogue. Stakeholder engagement identifies stakeholders, assesses stakeholder needs, develops stakeholder relations plans and forms alliances with stakeholders.
Stakeholder engagement leads to increased transparency, responsiveness, compliance, organizational learning, quality management, accountability and sustainability. Stakeholder engagement is a central feature of sustainability performance. Stakeholder engagement is undertaken for numerous reasons which include:

- Improved corporate responsibility and financial performance across the globe.
- To avoid conflict through negotiation, mediation and collaborative learning.
- Development of a shared vision to direct future business decisions and operations.
- To innovate through collaboration.

**Stakeholder engagement involves following steps:**

1. Identify stakeholder
2. Establish the goals and objectives of the company for engagement.
3. Identify stakeholder needs and interests.
4. Determine the stakeholder engagement strategy.
5. Evaluate outcome and internalize learnings.

Corporations are often confronted with the difficulty of balancing competing or opposing stakeholder needs or demands. The success of stakeholder engagement is initially dependent upon the quality of stakeholder analysis.

**Key principles of Stakeholder engagement**

- Communicate: Interactions from the various stakeholders should be promoted. Example: for customers there should be dedicated customer care center. The communication may be made through the print media elaborating about the progress of the company, which is also a part of the transparency and disclosure. Ensure intended message is understood and the desired response achieved.
- Consult, early and often: Always ask the right questions to get the useful information and ideas. To engage their support ask them for advice and listen how they feel.
- Remember, they are human: Operate with an awareness of human feelings.
- Plan it: Time investment and careful planning against it, has a significant payoff.
- Relationship: Try to engender trust with the stakeholders. Seek out networking opportunity.
- Simple but not easy: Show your care. Be empathetic. Listen to the stakeholders.
- Managing risk: Stakeholders can be treated as risk and opportunities that have probabilities and impact.
- Compromise: Compromise across a set of stakeholders’ diverging priorities.
- Understand what success is: Explore the value of the project to the stakeholder.
- Take responsibility: Project governance is the key of project success. It’s always the responsibility of everyone to maintain an ongoing dialogue with stakeholders.

**Benefits:** Stakeholder engagement provides opportunities to further align business practices with societal needs and expectations, helping to drive long-term sustainability and shareholder value. Stakeholder...
engagement is intended to help the practitioners fully realise the benefits of stakeholder engagement in their organization, to compete in an increasingly complex and ever-changing business environment, while at the same time bringing about systemic change towards sustainable development.

### Stakeholder Analysis

Stakeholder analysis is the identification of a project's/activity's key stakeholders, an assessment of their interests, and the ways in which these interests affect project riskiness and viability. It is linked to both institutional appraisal and social analysis: drawing on the information deriving from these approaches, but also contributing to the combining of such data in a single framework. Stakeholder analysis contributes to project design/activity design through the logical framework, and by helping to identify appropriate forms of stakeholder participation. It is the process of identifying the individuals or groups that are likely to affect or be affected by a proposed action, and sorting them according to their impact on the action and the impact the action will have on them. This information is used to assess how the interests of those stakeholders should be addressed in a project plan, policy, program, or other action.

Stakeholder analysis is a key part of stakeholder management. A stakeholder analysis of an issue consists of weighing and balancing all of the competing demands on a firm by each of those who have a claim on it, in order to arrive at the firm's obligation in a particular case. A stakeholder analysis does not preclude the interests of the stakeholders overriding the interests of the other stakeholders affected, but it ensures that all affected will be considered.

Doing a stakeholder analysis can:

- draw out the interests of stakeholders in relation to the problems which the project is seeking to address (at the identification stage) or the purpose of the project (once it has started)
- identify conflicts of interests between stakeholders
- help to identify relations between stakeholders which can be built upon, and may enable establish synergies
- help to assess the appropriate type of participation by different stakeholders.

The underlining factor in the stakeholder concept is that every activity of an organization should be based taking into account the interests of all the stakeholders. A holistic approach ensuring fairness to all the stakeholders is completely necessary for the sustainability of an enterprise.

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

The stakeholder concept suggests that the managers of a business should take into account their responsibilities to other groups – "not just the shareholder group" - when making decisions. The concept suggests that businesses can benefit significantly from cooperating with stakeholder groups, incorporating their needs in the decision-making process.

Stakeholder analysis helps with the identification of Stakeholders’ interests, Mechanisms to influence other stakeholders, Potential risks, Key people to be informed about the project during the execution phase and Negative stakeholders as well as their adverse effects on the project.
Better Stakeholder Engagement ensures Good Governance

Stakeholders are characterized by their relationship to the company and their needs, interests and concerns, which will be foremost in their minds at the start of an engagement process. However, as the process unfolds they will soon take a particular role with related tasks and responsibilities. The following are just some of the different roles that stakeholders can play:

- Experts, such as academics, who have been invited to contribute knowledge and strategic advice to the company’s board;
- Technical advisors with expertise on the social and environmental risks associated with particular technological and scientific developments invited to sit on scientific and ethical panels in science-based industries;
- Representatives of special interests, such as employees, local communities or the environment, commonly invited to participate in stakeholder panels to review company performance and/or reporting practices;
- Co-implementers, such as NGOs, who have partnered with the company to implement a joint solution or program to address a shared challenge.

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

Types of Stakeholders

The concept of stakeholders may be classified into Primary and Secondary Stakeholders:

- Primary stakeholders are those whose continued association is absolutely necessary for a firm’s survival; these include employees, customers, investors, and shareholders, as well as the governments and communities that provide necessary infrastructure.
- Secondary stakeholders do not typically engage in transactions with a company and thus are not essential for its survival; these include the media, trade associations, and special interest groups.

Both primary and secondary stakeholders embrace specific values and standards that dictate what constitutes acceptable or unacceptable corporate behaviors. While primary groups may present more day-to-day concerns, secondary groups cannot be ignored or given less consideration in the ethical decision-making process.

The Caux Round Table

The Caux Round Table (CRT) is an international network of business leaders working to promote a morally and sustainable way of doing business. The CRT believes that its Principles for Responsible Business provide necessary foundations for a fair, free and transparent global society.

The Caux Round Table was founded in 1986 by Frits Philips Sr, former President of Philips Electronics, and Olivier Giscard d’Estaing, former Vice-Chairman of INSEAD, as a means of reducing escalating international trade tensions between Europe, Japan and the USA.

At the urging of Ryuzaburo Kaku, then Chairman of Canon, Inc, the CRT began to focus attention on the importance of global corporate responsibility in reducing social and economic threats to world peace and stability. This led to the development of the 1994 Caux Round Table Principles for Business around
three ethical foundations, namely: responsible stewardship; the Japanese concept of Kyosei - living and working for mutual advantage; and respecting and protecting human dignity. These principles recognize that while laws and market forces are necessary, they are insufficient guides for responsible business conduct.

**CRT Principles for Responsible Business**

The 2009 CRT Principles for Responsible Business comprise seven principles and more detailed Stakeholder Management Guidelines covering each of the key stakeholder dimensions of ethical business practices: customers, employees, shareholders, suppliers, competitors, and communities.

The Caux Round Table believes that the world business community should play an important role in improving economic and social conditions. Through an extensive and collaborative process in 1994, business leaders developed the CRT Principles for Business to embody the aspiration of principled business leadership.

The CRT Principles for Business are a worldwide vision for ethical and responsible corporate behavior and serve as a foundation for action for business leaders worldwide. As a statement of aspirations, The CRT Principles aim to express a world standard against which business behavior can be measured.

The Caux Round Table has sought to begin a process that identifies shared values, reconciles differing values, and thereby develops a shared perspective on business behavior acceptable to and honored by all.

These principles are rooted in two basic ethical ideals: kyosei and human dignity:

- **Kyosei**: The Japanese concept of kyosei means living and working together for the common good enabling cooperation and mutual prosperity to coexist with healthy and fair competition.

- **Human dignity**: It refers to the sacredness or value of each person as an end, not simply as a mean to the fulfillment of others purposes or even majority prescription.

The Caux Round Table (CRT) Principles for Responsible Business set forth ethical norms for acceptable businesses behaviour.

Trust and confidence sustain free markets and ethical business practices provide the basis for such trust and confidence. But lapses in business integrity, whether among the few or the many, compromise such trust and hence the ability of business to serve humanity's needs. Events like the 2009 global financial crisis have highlighted the necessity of sound ethical practices across the business world. Such failures of governance and ethics cannot be tolerated as they seriously tarnish the positive contributions of responsible business to higher standards of living and the empowerment of individuals around the world.

The self-interested pursuit of profit, with no concern for other stakeholders, will ultimately lead to business failure and, at times, to counterproductive regulation. Consequently, business leaders must always assert ethical leadership so as to protect the foundations of sustainable prosperity.

It is equally clear that if capitalism is to be respected, and so sustain itself for global prosperity, it must be both responsible and moral. Business therefore needs a moral compass in addition to its practical reliance on measures of profit and loss.

The 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.
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 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. The Caux Round Table’s (CRT) Stakeholder Management Guidelines supplement the CRT Principles for Responsible Business with more specific standards for engaging with key stakeholder constituencies.

The key stakeholder constituencies are those who contribute to the success and sustainability of business enterprise. Customers provide cash flow by purchasing good and services; employees produce the goods and services sold, owners and other investors provide funds for the business; suppliers provide vital resources; competitors provide efficient markets; communities provide social capital and operational security for the business; and the environment provides natural resources and other essential conditions. In turn, key stakeholders are dependent on business for their well-being and prosperity. They are the beneficiaries of ethical business practices.

1. CUSTOMERS

A responsible business treats its customers with respect and dignity. Business therefore has a responsibility to:

a. Provide customers with the highest quality products and services consistent with their requirements.

b. Treat customers fairly in all aspects of business transactions, including providing a high level of service and remedies for product or service problems or dissatisfaction.

c. Ensure that the health and safety of customers is protected.

d. Protect customers from harmful environmental impacts of products and services.

e. Respect the human rights, dignity and the culture of customers in the way products and services are offered, marketed, and advertised.

2. EMPLOYEES

A responsible business treats every employee with dignity and respects their interests. Business therefore has a responsibility to:

a. Provide jobs and compensation that contribute to improved living standards

b. Provide working conditions that protect each employee’s health and safety.
c. Provide working conditions that enhance each employee’s well-being as citizens, family members, and capable and caring individuals

d. Be open and honest with employees in sharing information, limited only by legal and competitive constraints.

e. Listen to employees and act in good faith on employee complaints and issues.

f. Avoid discriminatory practices and provide equal treatment, opportunity and pay in areas such as gender, age, race, and religion.

g. Support the employment of differently-abled people in places of work where they can be productive.

h. Encourage and assist all employees in developing relevant skills and knowledge.

i. Be sensitive to the impacts of unemployment and work with governments, employee groups and other agencies in addressing any employee dislocations.

j. Ensure that all executive compensation and incentives further the achievement of long-term wealth creation, reward prudent risk management, and discourage excessive risk taking.

k. Avoid illicit or abusive child labor practices.

3. SHAREHOLDERS

A responsible business acts with care and loyalty towards its shareholders and in good faith for the best interests of the corporation. Business therefore has a responsibility to:

a. Apply professional and diligent management in order to secure fair, sustainable and competitive returns on shareholder investments.

b. Disclose relevant information to shareholders, subject only to legal requirements and competitive constraints.

c. Conserve, protect, and increase shareholder wealth.

d. Respect shareholder views, complaints, and formal resolutions.

4. SUPPLIERS

A responsible business treats its suppliers and subcontractors with fairness, truthfulness and mutual respect. Business therefore has a responsibility to:

a. Pursue fairness and truthfulness in supplier and subcontractor relationships, including pricing, licensing, and payment in accordance with agreed terms of trade.

b. Ensure that business supplier and subcontractor activities are free from coercion and threats.

c. Foster long-term stability in the supplier relationships in return for value, quality, competitiveness and reliability.

d. Share information with suppliers and integrate them into business planning.

e. Seek, encourage and prefer suppliers and subcontractors whose employment practices respect human rights and dignity.

f. Seek, encourage and prefer suppliers and subcontractors whose environmental practices meet best practice standards.

5. COMPETITORS

A responsible business engages in fair competition which is a basic requirement for increasing the wealth of
nations and ultimately for making possible the just distribution of goods and services. Business therefore has a responsibility to:

a. Foster open markets for trade and investment.
b. Promote competitive behavior that is socially and environmentally responsible and demonstrates mutual respect among competitors.
c. Not participate in anti-competitive or collusive arrangements or tolerate questionable payments or favors to secure competitive advantage.
d. Respect both tangible and intellectual property rights.
e. Refuse to acquire commercial information through dishonest or unethical means, such as industrial espionage.

6. COMMUNITIES

As a global corporate citizen, a responsible business actively contributes to good public policy and to human rights in the communities in which it operates. Business therefore has a responsibility to:

a. Respect human rights and democratic institutions, and promote them wherever practicable.
b. Recognize government’s legitimate obligation to society at large and support public policies and practices that promote social capital.
c. Promote harmonious relations between business and other segments of society.
d. Collaborate with community initiatives seeking to raise standards of health, education, workplace safety and economic well-being.
e. Promote sustainable development in order to preserve and enhance the physical environment while conserving the earth’s resources.
f. Support peace, security and the rule of law.
g. Respect social diversity including local cultures and minority communities.
h. Be a good corporate citizen through ongoing community investment and support for employee participation in community and civic affairs.

The Clarkson Principles of Stakeholder Management

The year after his retirement from the faculty of the University of Toronto in 1988, Max Clarkson (1922-1998) founded the Centre for Corporate Social Performance and Ethics in the Faculty of Management, now the Clarkson Centre for Business Ethics & Board Effectiveness, or CC(BE)2. Four conferences hosted by the Centre between 1993 and 1998 brought together management scholars to share ideas on stakeholder theory, an emerging field of study examining the relationships and responsibilities of a corporation to employees, customers, suppliers, society, and the environment. The Alfred P. Sloan Foundation funded the project, from which the Clarkson Principles emerged.

After an introduction to the stakeholder concept with comments on shareowners and the legal and moral duty of managers, seven (7) principles of Stakeholder Management are set forth, each with a paragraph or two expanding on its meaning. These principles represent an early stage general awareness of corporate governance concerns that have been widely discussed in connection with the business scandals of 2002.

- **Principle 1**: Managers should acknowledge and actively monitor the concerns of all legitimate
stakeholders, and should take their interests appropriately into account in decision-making and operations.

- **Principle 2:** Managers should listen to and openly communicate with stakeholders about their respective concerns and contributions, and about the risks that they assume because of their involvement with the corporation.

- **Principle 3:** Managers should adopt processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.

- **Principle 4:** Managers should recognize the interdependence of efforts and rewards among stakeholders, and should attempt to achieve a fair distribution of the benefits and burdens of corporate activity among them, taking into account their respective risks and vulnerabilities.

- **Principle 5:** Managers should work cooperatively with other entities, both public and private, to insure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.

- **Principle 6:** Managers should avoid altogether activities that might jeopardize inalienable human rights (e.g., the right to life) or give rise to risks which, if clearly understood, would be patently unacceptable to relevant stakeholders.

- **Principle 7:** Managers should acknowledge the potential conflicts between (a) their own role as corporate stakeholders, and (b) their legal and moral responsibilities for the interests of stakeholders, and should address such conflicts through open communication, appropriate reporting and incentive systems, and, where necessary, third party review.

In many ways, the Clarkson Principles are “meta-principles” that encourage management to embrace specific stakeholder principles and then to implement them in accordance with the norms listed above. Their current use seems largely hortatory, unlike principles or codes that call for formal adoption by managers or corporations.

### Governance Paradigm and Various Stakeholders

(a) **Employees:**

Earlier it was believed that shareholder’s primacy is supreme since they have contributed towards the capital and it leaves out role of employees. However with the growing that capital alone cannot do miracle and labour is also an equally important factor of the production.

Employee participation in corporate governance systems can be found in many countries and corporations throughout the world. Following are the some important example for ensuring good governance by employees:

- **Right to consultation** - where employees must be consulted on certain management decisions. This right increases transparency of management decisions and allows employee opinion to ameliorate the asymmetry of information between management and the market.

- **Right to nominate/vote for supervisory board members** - In many cases employee participation on the board is mandated. This right creates a check and balance system between management and the supervisory board, which in turn creates the perception of greater fairness.

- **Compensation/privatization programs** that make employees holders of shares, thereby empowering
employees to elect the board members, which, in turn holds management responsible.

- **Participation in the capital**: Employees may be partner in the capital contribution. They may be given the shares under the ESOP scheme. This will create the belongingness of the ownership concept among the employees meaning there by owner as well as employee. This will lead to the Improved employee commitment and buy-in to management's goals side by side the alignment of interest between employees and shareholders. It may support the emergence of more transparent and effective corporate governance.

- **Profit sharing**: The profit-sharing plans should be broad-based (all or most employees) rather than for executives only. This can be done in a variety of ways like: Cash-based sharing of annual profits, Deferred profit-sharing. The advantages of it are Encourage employee involvement, improve motivation, Improve distribution of wealth and Wage flexibility can improve firm performance.

- **Whistle Blower Policy**: A whistle blower is the one who exposes wrongdoing, fraud, corruption or 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, the 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.

**LESSON ROUND UP:**

- “Stakeholder Theory is an idea about how business really works. It says that for any business to be successful it has to create value for customers, suppliers, employees, communities and financiers, shareholders, banks and others people with the money.

- R. Edward Freeman defined Stakeholder Theory in broad definition of a stakeholder is any group or individual which can affect or is affected by an organization." Such a broad conception would include suppliers, customers, stockholders, employees, the media, political action groups, communities, and governments.

- A more narrow view of stakeholder would include employees, suppliers, customers, financial institutions, and local communities where the corporation does its business. But in either case, the claims on corporate conscience are considerably greater than the imperatives of maximizing financial return to stockholders.

- Stakeholder engagement is the process by which an organisation involves people who may be affected by the decisions it makes or can influence the implementation of its decisions.
The concept of stakeholders may be classified into Primary and Secondary Stakeholders.

The 2009 CRT Principles for Responsible Business comprise seven principles and more detailed Stakeholder Management Guidelines covering each of the key stakeholder dimensions of ethical business practices: customers, employees, shareholders, suppliers, competitors, and communities.

The CRT Principles for Responsible Business are supported by more detailed Stakeholder Management Guidelines covering each key dimension of business success: customers, employees, shareholders, suppliers, competitors, and communities.

Carlson introduced seven Principles of Stakeholder Management.

SELF-TEST QUESTIONS:
(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Why the concept from 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 9
Risk Management and Internal Control

LESSON OUTLINE

• Introduction
• Risk Management
• Risk Management Process
• Advantages of Risk Management
• Step in Risk Management
• Fraud Risk Management
• Reputation Risk Management
• Responsibility of Risk Management
• Role of Company Secretary in Risk Management
• Internal Control System
• COSO’s Internal Control Framework
• Components of Internal Control
• Relationship of Objective and Control
• Components and Principles
• What Internal Can Do & What Cannot do
• Role and Responsibility with regard to Internal Control
• Conclusions
• 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 internal control & 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 study further elaborates on the internal control systems, including COSO and roles and responsibilities with regard to internal control.

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**

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. Better risk management techniques provide early warning signals so that the same may addressed in time. In traditional concept the natural calamities like fire, earthquake, flood, etc were only treated as risk and keeping the safe guard equipments etc were assumed to have mitigated the risk. But due to rapid changes, the various types of risks have emerged viz. compliance risk, legal risk, country risk, operational risk (which we will discuss in this chapter). So in the ear of fast changing global economy, multiplicity of legal compliances, cross border business transactions and to ensure the survival, viability and sustainability of business, the management of the various types of risks have gained utmost importance.

**Risk Management**

What is Risk Management? It is not a particular event management rather it is a continuous process of identifying, evaluating and assessing the inherent and potential risk, adopting the methods for its systematic reduction in order to sustainable business development.

Risk Management is part of the corporate strategy. It is a key management tool to safeguard the business assets for its use for the productive purposes. Risk Management is a logical and systematic process of establishing the context, identifying, analysing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process, in a way that enables an organisation to minimise losses and maximise opportunities.

We take an example of a Forex Dept of a bank. How the Forex Dept keep a track on the currency risk since it is very much volatile. It uses the sophisticated techniques like, Dealer exposure limit, over the night exposure limit, hedging, merchant wise exposure limit, Value at Risk (VaR) etc to keep the risk within the manageable limits.

Risk may be controllable or uncontrollable. In other words, the systematic risk which stands at macro level is not controllable, but the unsystematic risk which is at micro level is controllable with the risk mitigation techniques.

**Classification of risks:** Risk may be classified according to controllability, i.e Controllable risk and Uncontrollable risk. In other words, the controllable risk is categorised as Unsystematic Risk and uncontrollable risk is categorised as Systematic Risk. The concept of controllable and uncontrollable risk may be further explained as under:

(a) **Systematic Risk:**

- It is uncontrollable by an organisation.
- It is not predictable.
- It is of Macro nature.
- It affects a large number of organisations operating under a similar stream.
- It cannot be assessed in advance.
• It depends on the influence of external factors on an organisation which are normally uncontrollable by an organisation.

• The example of such type of risk is Interest Rate Risk, Market Risk, Purchasing Power Risk.

(b) Unsystematic Risk:

• It is controllable by an organisation.
• It is predictable.
• It is Micro in nature.
• It affects the individual organisation.
• It can be assessed well in advance and risk mitigation can be made with proper planning and risk assessment techniques.
• The example of such risk is Business Risk, Liquidity Risk, Financial Risk, Credit Risk, Operational Risk.

Types of Risks

The risk may broadly be segregate as Financial Risk and Non-financial Risk.

(a) Financial Risk: The risk which has some financial impact on the business entity is treated as financial risk. These risks may be market risk, credit risk, Liquidity risk, Operational Risk, Legal Risk and Country Risk. The following chart depicts the various types of financial risks.

(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 benchmark index). Hence the market risk may be
defined as the risk to a firm due to the adverse changes in interest rates, currency rates, equity prices and commodity prices.

(a) **Interest Rate Risk:** The financial assets which are connected with interest factors such as bonds/debentures, faces the interest rate risk. Interest rate risk adversely affects value of fixed income securities. Any increase in the interest reduces the price of bonds and debts instruments in debt market and vice versa. So it can be said that the changes in the interested rates have an inverse relationship with the price of bonds.

(b) **Currency Risk:** The volatility in the currency rates is called the currency risk. These risks affect the firms which have international operations of business and the quantum of the risk depends on the nature and extent of transactions with the external market.

(c) **Equity Risk:** It means the depreciation in one’s investment due to the change in market index. Beta (β) of a stock tells us the market risk of that stock and it is associated with the day-to-day fluctuations in the market.

(d) **Commodity Risk:** This type of risk is associated with the absolute changes in the price of the commodity. Since commodities are physical assets, hence the prices are changed on account of the demand and supply factor.

(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 instalments 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 in the market. Liquidity is altogether different from the word solvency. A firm may be in sound position as per the balance sheet, but if the current assets are not in the form of cash or near cash assets, the firm may not make payment to the creditors which adversely affect the reputation of the firm. The liquidity risk
may be of two types, trading risk and funding risk.

(a) Trading Risk: It may mean the absence of the market liquidity i.e. inability to enter into derivative transactions with counter parties or make sales or purchase of securities.

(b) Funding Risk: It refers to the inability to meet the obligations by either borrowing or the sale of securities. It arises where the balance sheet of a firm contains illiquid financial assets which can not 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, 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.

(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 etc.

(vi) Political/Country Risk: Political risk may be on account of declaration of elections in the territory, area specific risk. The Country risk arises where the firm have its business operations abroad. This risk may arise due to out-break of war between countries, imposition of the ban on the business transaction of particular commodity/product.

(b) Non-Financial Risk: This type of risk do not have immediate financial impact on the business, but its consequence are very serious and later may have the financial impact. This type of risk may include, Business/Industry & Service Risk, Strategic Risk, Compliance Risk, Fraud Risk, Reputation Risk, Transaction risk, Disaster Risk.

(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: Unsuccessful business plan since its inception may lead to strategic risk. For example, strategic risk might arise from making poor business decisions, from the substandard execution of decisions, from inadequate resource allocation, or from a failure to respond well to changes in the business environment.
(iii) **Compliance Risk:** This risk arises on account of non-compliance of breaches of laws/ regulations which the entity is supposed to adhere. It may result to deterioration to public reputation, penalty and penal provisions.

(iv) **Fraud Risk:** Fraud is perpetrated through the abuse of systems, controls, procedures and working practices. It may be performed by the outsider or even from the insider. Often the most trusted employee attempt to do this. Fraud may not be detected immediately, but is still usually discovered by chance, but the detection should be proactive rather than reactive.

(v) **Reputation Risk:** This type of risk arises from the negative public opinion. Such type of risk may arise from the failure to assess and control compliance risk and can result in harm to existing or potential business relationships.

(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.

**Risk Management Process**

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 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 pertinent to note that every activity carries a potential reward as well. Risk management, essentially, is about managing risk against reward.

**Advantages of Risk Management**

Risk management plays vital role in strategic planning. It is an integral part of project management. An effective risk management focuses on identifying and assessing possible risks. The advantages of having risk management are as under:

- Risk Management always results in significant cost savings and prevents wastage of time and effort in firefighting. It develops a Robust contingency planning.
- It can help plan and prepare for the opportunities that unravel during the course of a project or business.
- Risk Management improves strategic and business planning. It reduces costs by limiting legal action or preventing breakages.
- It establishes improved reliability among the stake holders leading to an enhanced reputation.
• Sound Risk Management practices reassure key stakeholders throughout the organization.
• Risk Management strongly favours a focussed internal audit programme.

**Steps in Risk Management:**

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

- **Identification of risk:** It is the first phase of the risk management process. 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.

- **Assessment of risk:** After identifying the origin of the risk the second step is assessment of the risk. A business organisation faces various threats and vulnerabilities that may affect its operation or the fulfilment of its objectives. Hence identification, analysis and evaluation of these threats and vulnerabilities are the only way to understand and measure the impact of the risk involved and hence to decide on the appropriate measures and controls to manage them.

- **Analysing and evaluating the risk:** It is the third step where the level of risk and its nature are assessed and understood. There should be a centralised risk frame work to document all such risks which is being or will be faced by the organisation. The risk analysis involves thorough examination of the risk sources, its positive and negative consequences, the likelihood of the consequences that may occur and the factors that affect them and assessment of any existing controls or processes that tend to minimize negative risks or enhance positive risks.

- **Handling of risk:** The ownership of risk should be allocated. 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:

- **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.

- **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.

- **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 saving in losses and other risk costs; in other words, risk prevention generally
should be evaluated in the same way as other investment projects.

- **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, at least in part of any resultant economic loss.

- **Implementation of risk management decision:** The implementation of the risk management
decision taken by the Risk Management Dept is to be adhered by the operational staff. Risk
management is the commitment from the top management. It is no longer at their discretion. It
is a tool for creating opportunities for the businesses as they develop during the risk
management process. Thus, Risk Management Process provides a framework to:
  - 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.

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**Standard on Implementation of Risk Management**

**ISO 31000:2009:** International Organization for Standardization (ISO)) is a worldwide federation of national
standards bodies (ISO member bodies). The work of preparing International Standards is normally carried out through ISO technical committees. Each member body interested in a subject for which a technical committee has been established has the right to be represented on that committee. International organizations, governmental and non-governmental, in liaison with ISO, also take part in the work. The main task of technical committees is to prepare International Standards.

Every activity of an organization involves risk. Organizations manage risk by identifying it, analysing it and then evaluating whether the risk should be modified by risk treatment in order to satisfy their risk criteria. Throughout this process, they communicate and consult with stakeholders and monitor and review the risk and the controls that are modifying the risk in order to ensure that no further risk treatment is required. This International Standard describes this systematic and logical process in detail. Risk management can be applied to an entire organization, at its many areas and levels, at any time, as well as to specific functions, projects and activities.

ISO 31000 published on the 13th of November 2009, provides a standard on the implementation of risk management. ISO 31000 seeks to provide a universally recognised paradigm for practitioners and companies employing risk management processes. Accordingly, the general scope of ISO 31000 - is not developed for a particular industry group, management system or subject matter field in mind, rather it provides best practice structure and guidance to all operations concerned with risk management. The scope of this approach to risk management is to enable all strategic, management and operational tasks of an organization throughout projects, functions, and processes be aligned to a common set of risk management objectives.

ISO 31000 contains 11 key principles that position risk management as a fundamental process in the success of the organization.

ISO 31000 is designed to help organizations:

- Increase the likelihood of achieving objectives
- Encourage proactive management
- Be aware of the need to identify and treat risk throughout the organization
- Improve the identification of opportunities and threats
- Comply with relevant legal and regulatory requirements and international norms
- Improve financial reporting
- Improve governance
- Improve stakeholder confidence and trust
- Establish a reliable basis for decision making and planning
- Improve controls
- Effectively allocate and use resources for risk treatment
- Improve operational effectiveness and efficiency
- Enhance health and safety performance, as well as environmental protection
- Improve loss prevention and incident management
- Minimize losses
- Improve organizational learning
- Improve organizational resilience.
ISO 31000 provides that risk oversight is a key duty of the board, as failure to manage risk can threaten the existence of the entity being governed. Countries are exploring how to improve the overall risk management framework including examining the responsibilities of different board committees.

**Frauds Risk Management**

Fraud is a deliberate action to deceive another person with the intention of gaining some things. Fraud can loosely be defined as “any behavior by which one person intends to gain a dishonest advantage over another”. In other words, fraud is an act or omission which is intended to cause wrongful gain to one person and wrongful loss to the other, either by way of concealment of facts or otherwise.

Section 25 of the Indian Penal Code, 1860 defines the word, “Fraudulently”, which means, a person is said to do a thing fraudulently if he does that thing with intent to defraud but not otherwise.

Further according to section 17 of the Indian Contract Act, 1872, ‘fraud’ means and includes any of the following acts committed by a party to a contract, or with his connivance (intentional active or passive acquiescence), or by his agent with intent to deceive or to induce a person to enter into a contract.

1. The suggestion that a fact is true when it is not true and the persons making the suggestion does not believe it to be true;
2. The active concealment of a fact by a person having knowledge or belief of the fact;
3. A promise made without any intention of performing it;
4. Any other act fitted to deceive;
5. Any such act or omission as the law specially declares to be fraudulent.

The Companies Act 2013 has also explained fraud under Section 447 as “fraud” in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.

A definition of fraud has been suggested in the context of electronic banking in the Report of RBI Working Group on Information Security, Electronic Banking, Technology Risk Management and Cyber Frauds, which reads as under: “A deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the books of accounts maintained manually or under computer system in banks, resulting into wrongful gain to any person for a temporary period or otherwise, with or without any monetary loss to the bank”.

For prevention of the fraud, there should be in existence a robust internal check and control systems. For example in banking there is a concept of ‘maker’ and ‘checker’. The day today transactions are entered by the maker and another person validates the transactions. So it is a self balancing system. Further the internal/concurrent audit also helps in early detection of the frauds.

The management should be pro-active in fraud related matter. A fraud is usually not detected until and unless it is unearthed. Fraud Risk Management Policy be incorporated, aligned to its internal control and risk management. Such policy/plan protects the company from any kind of uncertain happening which leads the company to a huge loss or damage (brand reputation, financial loss, assets).

The Fraud Risk Management Policy will help to strengthen the existing anti-fraud controls by raising the awareness across the Company and (i) Promote an open and transparent communication culture (ii) Promote zero tolerance to fraud/misconduct (iii) Encourage employees to report suspicious cases of
fraud/misconduct. (iv) Spread awareness amongst employees and educate them on risks faced by the company.

Such a policy may include the following:

- **Defining fraud:** This shall cover activities which the company would consider as fraudulent.
- **Defining Role & responsibilities:** The policy may define the responsibilities of the officers who shall be involved in effective prevention, detection, monitoring & investigation of fraud. The company may also consider constituting a committee or operational structure that shall ensure an effective implementation of anti-fraud strategy of the company. This shall ensure effective investigation in fraud cases and prompt as well as accurate reporting of fraud cases to appropriate regulatory and law enforcement authorities.
- **Communication channel:** Encourage employees to report suspicious cases of fraud/misconduct. Any person with knowledge of suspected or confirmed incident of fraud/misconduct must report the case immediately through effective and efficient communication channel or mechanism.
- **Disciplinary action:** After due investigations disciplinary action against the fraudster may be considered as per the company’s policy.
- **Reviewing the policy:** The employees should educate their team members on the importance of complying with Company’s policies & procedures and identifying/reporting of suspicious activity, where a situation arises. Based on the developments, the policy should be reviewed on periodical basis.

**Reporting of fraud under Companies Act 2013**

The Companies Act, 2013 has introduced many new reporting requirements for the statutory auditors of companies. One of these requirements is given under the Section 143(12) of the Companies Act, 2013 which requires the statutory auditors or cost accountant or company secretary in practice to report to the Central Government about the fraud/suspected fraud committed against the company by the officers or employees of the company.

Sub-section 12 of Section 143 of the Companies Act, 2013 states, “Notwithstanding anything contained in this section, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed.”

The reporting requirement under Section 143(12) is for the statutory auditors of the company and also equally applies to the cost accountant in practice, conducting cost audit under Section 148 of the Act; and to the company secretary in practice, conducting secretarial audit under Section 204 of the Act.

Section 143(12) includes only fraud by officers or employees of the company and does not include fraud by third parties such as vendors and customers.

**Secretarial Audit**

Secretarial Audit is a process to check compliance with the provisions of all applicable laws and rules/regulations/procedures; **adherence to good governance practices** with regard to the systems and processes of seeking and obtaining approvals of the Board and/or shareholders, as may be necessary, for
the business and activities of the company, carrying out activities in a lawful manner and the maintenance of
minutes and records relating to such approvals or decisions and implementation. Section 204 of Companies
Act 2013 provides for Secretarial audit for bigger companies.

(1) Every listed company and a company belonging to other class of companies as may be prescribed
shall annex with its Board’s report made in terms of sub-section (3) of section 134, a secretarial
audit report, given by a **company secretary in practice**, in such form as may be prescribed. Rule 9
of Companies (Appointment and Remuneration of Managing Personnel) Rules, 2014 provides that
for the purposes of sub-section (1) of section 204, the other class of companies shall be as under-
- every public company having a paid-up share capital of fifty crore rupees or more; or
- every public company having a turnover of two hundred fifty crore rupees or more.

(2) It shall be the duty of the company to give all assistance and facilities to the company secretary in
practice, for auditing the secretarial and related records of the company.

(3) The Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain
in full any qualification or observation or other remarks made by the company secretary in practice
in his report under sub-section (1).

(4) If a company or any officer of the company or the company secretary in practice, contravenes the
provisions of this section, the company, every officer of the company or the company secretary in
practice, who is in default, shall be punishable with fine which shall not be less than one lakh rupees
but which may extend to five lakh rupees.

**Reputation Risk Management**

The Reserve Bank of India in its Master Circular number RBI/2015-16/85 DBR.No.BP.BC.4./21.06.001/2015-
16 July 1, 2015 has defined the Reputation Risk as the risk arising from negative perception on the part of
customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties or
regulators that can adversely affect a bank’s ability to maintain existing, or establish new, business
relationships and continued access to sources of funding (eg through the interbank or securitisation
markets). Reputational risk is multidimensional and reflects the perception of other market participants.
Furthermore, it exists throughout the organisation and exposure to reputational risk is essentially a function
of the adequacy of the bank’s internal risk management processes, as well as the manner and efficiency with
which management responds to external influences on bank-related transactions.

Loss of Reputation has long lasting damages:

- It destroys the Brand Value
- Steep downtrend in share value.
- Ruined of Strategic Relationship
- Regulatory relationship is damaged which leads to stringent norms.
- Recruitment to fetch qualified staff as well the retention of the old employees becomes difficult.

For managing the reputation risk, the following principles are worth noting:

- Integration of risk while formulating business strategy.
- Effective board oversight.
- Image building through effective communication.
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- Promoting compliance culture to have good governance.
- Persistently following up the Corporate Values.
- Due care, interaction and feedback from the stakeholders.
- Strong internal checks and controls
- Peer review and evaluating the company’s performance.
- Quality report/newsletter publications
- Cultural alignments

**Responsibility of Risk Management:**

Section 134(3) (n) of the Companies Act, 2013 provides that a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company.

**SEBI (LODR) Regulations, 2015** also provides that company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.

The Risk Management Plan must include all elements of risks. The traditional elements of potential likelihood and potential consequences of an event must be combined with other factors like the timing of the risks, the correlation of the possibility of an event occurring with others, and the confidence in risk estimates.

Risk management policies should reflect the company’s risk profile and should clearly describe all elements of the risk management and internal control system and any internal audit function. A company’s risk management policies should clearly describe the roles and accountabilities of the board, audit committee, or other appropriate board committee, management and any internal audit function.

A company should have identified Chief Risk Officer manned by an individual with the vision and the diplomatic skills to forge a new approach. He may be supported by “risk groups” to oversee the initial assessment work and to continue the work till it is completed.

An integrated approach to risk management deals with various risks as they affect organizational objectives and limitations. The aim must be to develop a culture of risk awareness and understanding. This helps better decision making in day-to-day work by all employees.

**SEBI (LODR) Regulations, 2015, requires that every listed company should have a Risk Management Committee.**

- The 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 through its Board of Directors shall constitute a Risk Management Committee. The Board shall define the roles and responsibilities 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.
- The majority of Committee shall consist of members of the Board of Directors.
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/She 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.

Section 205 (1) of the Companies Act, 2013 deals with the functions of the company secretary. It provides that the functions of the company secretary shall include,—

(a) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;

(b) to ensure that the company complies with the applicable secretarial standards;

(c) to discharge such other duties as may be prescribed.

Rule 10 of the Companies (Appointment & Remuneration of Managerial Personnel) Rules 2014 specifies that the duties of Company Secretary shall also discharge, the following duties, namely:-

(a) to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;

(b) to facilitate the convening of meetings and attend Board, committee and general meetings and maintain the minutes of these meetings;

(c) to obtain approvals from the Board, general meeting, the government and such other authorities as required under the provisions of the Act;

(d) to represent before various regulators, and other authorities under the Act in connection with discharge of various duties under the Act;

(e) to assist the Board in the conduct of the affairs of the company;

(f) to assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices; and

(g) to discharge such other duties as have been specified under the Act or rules; and

(h) such other duties as may be assigned by the Board from time to time.

The listing agreement also provides for the establishment of the Risk Management Committee as per Regulations. Since it is the part of the Corporate Governance norms and non-compliance of the same is to be reported by the Company Secretary.
In terms of Section 203(1)(ii), a Company Secretary is a Key Managerial Person. Hence being a top level officer and board confidante, a Company Secretary can play a role in ensuring that a sound Enterprise wide Risk Management [ERM] which is effective throughout the company is in place. The board of directors may have a risk management sub-committee assisted by a Risk Management Officer. As an advisor to the board in ensuring good governance, a Company Secretary shall ensure that there is an Integrated Framework on which a strong system of internal control is built. Such a Framework will become a model for discussing and evaluating risk management efforts in the organization. Risk and control consciousness should spread throughout the organization. A Company Secretary can ensure that this happens so that the risk factor will come into consideration at the every stage of formulation of a strategy. It will also create awareness about inter-relationships of risks across business units and at every level of the organization. A Company Secretary can ensure that the following questions [an illustrative list] are effectively addressed at the board level:

- What is the organization’s risk management philosophy?
- Is that philosophy clearly understood by all personnel?
- What are the relationships among ERM, performance, and value?
- How is ERM integrated within organizational initiatives?
- What is the desired risk culture of the organization and at what point has its risk appetite been set?
- What strategic objectives have been set for the organization and what strategies have been or will be implemented to achieve those objectives?
- What related operational objectives have been set to add and preserve value?
- What internal and external factors and events might positively or negatively impact the organization’s ability to implement its strategies and achieve its objectives?
- What is the organization’s level of risk tolerance?
- Is the chosen risk response appropriate for and in line with the risk tolerance level?
- Are appropriate control activities (i.e., approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, segregation of duties) in place at every level throughout the organization?
- Is communication effective — from the top down, across, and from the bottom up the organization?
- How effective is the process currently in place for exchanging information with external parties?
- What is the process for assessing the presence and performance quality of all eight ERM components over time?

**INTERNAL CONTROL SYSTEM**

Control involves certain checks and procedures to prevent the frauds or misappropriation of business assets. Earlier the internal control was seen as mere accounting guidelines but the scenario has gradually changed and the concept of internal control now indicates the whole system of controls, financial or otherwise, established by the management in the conduct of a business, including internal check, internal audit and other forms of control.

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.’
According to, The Institute of Chartered Accounts of England and Wales, the internal control is meant not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, safeguarding its assets and secure as far as possible the accuracy and reliability of its records.

The objectives of the internal control system may be enumerated as under:

- It avoids/minimises the possibility of errors and frauds.
- It have inbuilt system of detection of errors and frauds.
- It increases the efficiency and the staff may be assure that if anything went wrong even by mistake, will be checked by another independent person.
- The probability of misappropriation and fraud are minimised.

**Essentials for Internal Control:** However for effective implementation of the internal control system, the followings are pre-requisites:

- 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 rotation of the staff duties periodically.
- Staff should be asked to go on mandatory leave periodically so that other person may come to know if someone is playing foul with the system.
- Persons having the charge of the important assets should not be allowed to have access to the books of accounts.
- Periodical inspection of the physical assets be carried out to ensure its physical existence as well in good working conditions.
- The valuable items like cash and others, by physically inspected and the periodicity should be at irregular intervals, so that the person under whose charge the assets are, cannot know in advance, when the inspection will took place and manage the affairs.

Section 177(5) of the Companies Act, 2013 provides that the Audit Committee may call for the comments of the auditors about **internal control systems**, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

SEBI (LODR) Regulations also provide that directors’ report should included a Management Discussion and Analysis report. This Management Discussion & Analysis Report, apart from other points should also comment on the **Internal control systems and their adequacy.**
So the Companies Act, 2013 as well as the Listing Obligations require comments on the Internal Control System. The internal control structure may be referred as the policies and procedures established by the entity to provide reasonable assurance that the objectives are achieved.

**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).

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.

Components and Principles

The Framework sets out five components of internal control and seventeen principles representing the fundamental concepts associated with components. These components and principles of internal control are suitable for all entities. All seventeen principles apply to each category of objective, as well as to objectives and sub-objectives within a category. For instance, an entity may apply the Framework relative to complying with a specific law regarding commercial arrangements with foreign entities, a subcategory of the compliance category of objectives.

Below is a summary of each of the five components of internal control and the principles relating to components. Each of the principles is covered in the respective component chapters.

(1) Control Environment: The control environment is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization. The control environment comprises the integrity and ethical values of the organization; the parameters enabling the board of directors to carry out its governance oversight responsibilities; the organizational structure and assignment of authority and responsibility; the process for attracting, developing, and retaining competent individuals; and the rigor around performance measures, incentives, and rewards to drive accountability for performance. The resulting control environment has a pervasive impact on the overall system of internal control.

There are five principles relating to Control Environment:

- The organization demonstrates a commitment to integrity and ethical values.
- The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.
- Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
- The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
- The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

(2) Risk Assessment: Every entity faces a variety of risks from external and internal sources. Risk assessment involves a dynamic and iterative process for identifying and assessing risks to the achievement of objectives. A precondition to risk assessment is the establishment of objectives, linked at different levels of the entity. Risk assessment also requires management to consider the impact of possible changes in the external environment and within its own business model that may render internal control ineffective. There are four principles relating to the risk assessment.

- The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
- The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.
- The organization considers the potential for fraud in assessing risks to the achievement of objectives.
- The organization identifies and assesses changes that could significantly impact the system of internal control.

(3) Control Activities: Control activities are the actions established through policies and procedures that help ensure that management’s directives to mitigate risks to the achievement of objectives are carried out. Control activities are performed at all levels of the entity, at various stages within business processes, and over the technology environment. There are three principles relating to the control activities:

- The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
- The organization selects and develops general control activities over technology to support the achievement of objectives.
- The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.

(4) Information and Communication: Information is necessary for the entity to carry out internal control responsibilities to support the achievement of its objectives. Management obtains or generates and uses relevant and quality information from both internal and external sources to support the functioning of other components of internal control. Communication is the continual, iterative process of providing, sharing, and obtaining necessary information. Internal communication is the means by which information is disseminated throughout the organization, flowing up, down, and across the entity. External communication is twofold: it enables inbound communication of relevant external information, and it provides information to external parties in response to requirements and expectations. There are three principles relating to Information and Communication:

- The organization obtains or generates and uses relevant, quality information to support the functioning of other components of internal control.
- The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control.
- The organization communicates with external parties regarding matters affecting the functioning of other components of internal control.

(5) Monitoring Activities: Ongoing evaluations, separate evaluations, or some combination of the two are used to ascertain whether each of the five components of internal control, including controls to effect the principles within each component, is present and functioning. Ongoing evaluations, built into business processes at different levels of the entity, provide timely information. Separate evaluations, conducted periodically, will vary in scope and frequency depending on assessment of risks, effectiveness of ongoing evaluations, and other management considerations. Findings are evaluated against criteria established by regulators, recognized standard-setting bodies or management and the board of directors, and deficiencies are communicated to management and the board of directors as appropriate. There are two principles relating to Monitoring Activities:

- The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.
The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

What Internal Control CAN DO and what CANNOT DO:

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.

What Internal Control Cannot Do:
- 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.

Conclusions

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.

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 do not have immediate financial impact on the business, but its consequence are 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.

- 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 the 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.

SELF TEST QUESTIONS

1. What do you mean by Risk Management?
2. Discuss about the Controllable and Un-controllable Risks.
3. Elaborate on different types of Financial and Non-financial Risk.
4. Describe the Risk Management Process and its advantages?
5. What do you understand by Fraud risk? What strategy can adopt to mitigate such a risk?
6. Write short notes on:
   b. Fraud Risk Management
   c. Reputation Risk Management
   d. Secretarial Audit and Role of Company Secretary
7. Discuss in detail about the COSO’s Internal Control Framework.
8. Write a note on the roles and responsibilities of Internal Control System.
Lesson 10
Corporate Governance in Banks, Insurance and Public Sector Companies

LESSON OUTLINE
- Corporate Governance norms for Bank/Insurance/Public Sector Companies
- Classification of Banks
- Regulations of Banks
  - SBI Act, 1955
  - Banking Companies (Acquisition & Transfer of Undertakings) Act, 1970
  - Banking Regulation Act, 1949.
- Corporate Governance in Banks
- Corporate Governance in Insurance Companies.
- Corporate Governance in Public Sector Enterprises.
- CSR & Sustainability for Central Public Enterprises
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES
The objective of the study lesson is to enable the students to understand legislative framework of Corporate Governance in the Banks, Insurance Companies and Public Sector Undertakings (PSUs).

The Companies Act, 2013 is applicable to all companies registered under the Act. However the same is not the case with nationalized banks as these are governed by separate Acts. The chapter explains the Ganguly Committee Report on Corporate Governance in Banks, and Corporate Governance under the Basel I, II and III. The Insurance companies are also subject to compliance with IRDA guidelines in addition to other applicable legislations. The guidelines issued by the IRDA on the Corporate Governance norms applicable to the Insurance Company have been dealt with in the chapter.

The PSUs/CPSEs are subject to additional supervision and compliance of DPE/Vigilance/C&AG directives as compare to the private sector companies.

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

The CSR and Sustainability for the Central Public Enterprises provisions as per Companies Act 2013 which are applicable to CPEs have been included in it.

We have now moved from diversified ecology of small banks, with varied lending policies to a more homogeneous framework of firms that all resemble one another

– Nassim Nicholas Tateb
Corporate Governance norms for Banks/Insurance/ Public Sector Companies

The sector specific companies i.e. banking/insurance/ public sector, may be listed or unlisted companies. If they are listed with any stock exchanges, they have to adhere to the listing agreements. The provisions of the Companies’ Act 2013 are also applicable to both listed as well as unlisted companies. However, since these companies are sector specific hence they are required to follow the regulatory norms prescribed by their sectoral regulator. For example: Banks are governed by the Banking Regulation Act, 1949 and come under the control of the Reserve Bank of India. Hence directions of the RBI have to be followed. Similarly the insurance companies comes under the purview of the IRDA so apart from the Listing Regulations (if they are listed companies) and the Companies Act, 2013, they also have to adhere the norms prescribes by the RBI/IRDA etc.

Classification of Banks

Banks may be classified as Scheduled and Non-scheduled commercial banks.

(a) Scheduled bank: As per section 2(e) of The Reserve Bank of India Act, 1934, ‘scheduled bank’ means a bank included in the Second Schedule.

Conditions for inclusion of name of a bank in Second Schedule: Section 42(6)(a) of the RBI Act, 1934 narrates the following conditions for inclusion of the name of a bank in the Second Schedule:

(i) has a paid-up capital and reserves of an aggregate value of not less than five lakhs of rupees, and

(ii) satisfies the Bank (RBI) that its affairs are not being conducted in a manner detrimental to the interests of its depositors, and

(iii) is a State co-operative bank or a company as defined in section 3 of the Companies Act, 1956, or an institution notified by the Central Government in this behalf or a corporation or a company incorporated by or under any law in force in any place outside India.

Conditions for exclusion of name of a bank from the Second Schedule: Section 42(6)(b) of the RBI Act, 1934 narrates the following conditions for exclusion of name of a bank from the Second Schedule:

(i) the aggregate value of whose paid-up capital and reserves becomes at any time less than five lakhs of rupees, or

(ii) was, in the opinion of the Bank after making an inspection under section 35 of the Banking Regulation Act, 1949, conducting its affairs to the detriment of the interest of its depositors or,

(iii) which goes into liquidation or otherwise ceases to carry on banking business.

Scheduled banks are required to maintain Cash Reserve Ratio (CRR) with RBI in terms of section 42(1) of the RBI Act, 1934 and also maintain Statutory Liquidity Ratio (SLR) in terms of section 24 of the Banking Regulation Act, 1949.

(b) Non-scheduled bank: It means those banks, whose names have not been included in the Second Schedule of the RBI Act, 1934. The non-scheduled banks are required to maintain by way of cash reserve with itself or with RBI in terms of section 18 of the Banking Regulation Act, 1949.

The banks may also be classified in the following way:

- **State Bank of India:** The State Bank of India Act, 1955 came into force w.e.f 1st July, 1955.
• **SBI Associate Banks:** To provide for the formation of certain Government or Government associated banks as subsidiaries of the State Bank of India, an Act called as the State Bank of India (Subsidiary Banks) Act, 1959 was enacted and it came into force 10th September, 1959. These SBI and associate banks are called the Govt of India Undertakings.

• **Nationalised Banks:** In 1969, the Government of India issued an Ordinance, Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969, and 14 scheduled commercial banks were nationalised in order to expand the branch network, followed by six more in 1980. The ordinance was thereafter enacted as Act namely The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970) and The Banking Companies (Acquisition and Transfer of Undertakings) act, 1980 (40 of 1980). These nationalised banks are called the Govt of India Undertakings.

• **Old/New Private Sector Banks:** The ownership of these banks are scattered among the individuals, institutions, mutual funds and companies and are not the Government banks, but they are governed and controlled by the RBI guidelines and directives. Among old private sector banks, it includes J & K Bank, Federal Bank etc and ICICI Bank, HDFC Bank, Axis Bank etc. are the new generation banks.

• **State/District Co-operative Banks:** A cooperative bank is a cooperative society registered or deemed to have been registered under any State or Central Act. If a cooperative bank is operating in more than one State, the Central Cooperative Societies Act is applicable. In other cases the State laws are applicable. Apart from various other laws like the Banking Laws (Application to Co-operative Societies) Act, 1965 and Banking Regulation (Amendment) and Miscellaneous Provisions Act, 2004, the provisions of the RBI Act, 1934 and the BR Act, 1949 would also be applicable for governing the banking activities.

• **Regional Rural Banks (RRBs):** These banks were established under The Regional Rural Banks Act, 1976 (21 of 1976). These banks are sponsored by nationalized banks and the capital contribution is in the ratio of 50% by Central Govt, 15% by State Govt and 35% by the concerned sponsored bank. These banks established with the focused attention of the local villagers financial needs.

• **Local Area Banks (LABs):** Local Area Banks with operations in two or three contiguous districts were conceived in the 1996 Union budget to mobilise rural savings and make them available for investments in local areas. They are expected to bridge the gaps in credit availability and enhance the institutional credit framework in rural and semi-urban areas. Although the geographical area of operation of such banks is limited, they are allowed to perform all functions of a scheduled commercial bank.

• **Foreign Banks:** The other important segment of the commercial banking is that of foreign banks. Foreign banks have their registered offices outside India, and through their branches they operate in India. Foreign banks are allowed on reciprocal basis. They are allowed to operate through branches or wholly owned subsidiaries.

### Regulation of Banks

As discussed above, we have seen that the banks have been established under the different statutes. The SBI is governed by the State Bank of India Act, 1955, while its associate banks are governed by the State Bank of India (Subsidiary Banks) Act, 1959. Nationalized banks are governed by the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980. The private sector banks came into being as company registered under the
Companies Act (whether under the Companies Act, 2013/1956 or under the Indian Companies Act, 1913 or prior to that).

(A) State Bank of India Act 1955: Section 19 of the Act deals with the Composition of the Central Board. It provides that Central Board shall consist of the following, namely:

(a) Chairman to be appointed by the Central Government in consultation with the Reserve Bank

(b) Such number of managing directors not exceeding four, as may be appointed by the Central Government in consultation with the Reserve Bank.

(c) If the total amount of the holdings of the shareholders, other than the Central Government, whose names are on the register of shareholders three months before the date fixed for election of directors is -

(i) not more than ten per cent of the total issued capital, two directors,
(ii) more than ten percent but not more than twenty-five percent of such capital, three directors, and
(iii) more than twenty-five per cent of such capital, four directors, to be elected in the prescribed manner by such shareholders;

(ca) one director, from among the employees of the State Bank, who are workmen, to be appointed by the Central Government in the manner provided in the rules made under this Act;

(cb) one director, from among such of the employees of the State Bank, as are not workmen, to be appointed by the Central Government in the manner provided in the rules made under this Act;

(d) not less than two and not more than six directors to be nominated by the Central Government from among persons having special knowledge of the working of co-operative institutions and of rural economy or experience in commerce, industry, banking or finance;

(e) one director to be nominated by the Central Government; and

(f) one director, possessing necessary expertise and experience in matters relating to regulation or supervision of commercial banks, to be nominated by the Central Government on the recommendation of the Reserve Bank.

(B) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970

Section 9(3) of the said Act provides that every Board of Directors of a corresponding new bank constituted under any scheme made under sub-section (1), shall include-

(a) not more than four whole time Directors to be appointed by the Central Government after consultation with the Reserve Bank;

(b) one Director who is an official of the Central Government to be nominated by the Central Government:

PROVIDED that no such Director shall be a Director of any other corresponding new bank.

Explanation: For the purposes of this clause, the expression "corresponding new bank" shall include a corresponding new bank within the meaning of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980);

(c) one director, possessing necessary expertise and experience in matters relating to regulation or supervision of commercial banks, to be nominated by the Central Government on the recommendation of the Reserve Bank;
Explanation: For the purposes of this clause, "an officer of the Reserve Bank" includes an officer of the Reserve Bank who is deputed by that bank under Section 54AA of the Reserve Bank of India Act, 1934 (2 of 1934) to any institution referred to therein;

(d) Omitted by amendment dated 25.09.06, effective 16.10.06.

(e) one Director, from among such of the employees of the corresponding new bank who are workmen under clause (s) of section 2 of the Industrial Disputes Act, 1947 (14 of 1947) to be nominated by the Central Government in such manner as may be specified in a scheme made under this section;

(f) one Director, from among the employees of the corresponding new bank who are not workmen under clause(s) of section 2 of the Industrial Disputes Act, 1947, (14 of 1947) to be nominated by the Central Government after consultation with the Reserve Bank;

(g) one Director who has been a Chartered Accountant for not less than fifteen years to be nominated by the Central Government after consultation with the Reserve Bank;

(h) subject to the provisions of clause (i), not more than six Directors to be nominated by the Central Government; (i) where the capital issued under clause (c) of sub-section (2B) of section (3) is- (I) not more than sixteen per cent of the total paid-up capital, one director; (II) more than sixteen per cent but not more than thirty two per cent of the total paid-up capital, two directors, (III) more than thirty two per cent of the total paid-up capital, three directors, to be elected by the shareholders, other than the Central Government, from amongst themselves:

PROVIDED that on the assumption of charge after election of any such director under this clause, equal number of directors nominated under clause (h) shall retire in such manner as may be specified in the scheme.

PROVIDED FURTHER that in case the number of directors elected, on or before the commencement of the Banking Companies (Acquisition and Transfer of Undertakings) and Financial Institutions Laws (Amendment) Act, 2006 in a corresponding new Bank exceed the number of directors specified in sub-clause (I) or sub – clause (II) or sub – clause (III), as the case may be, such excess number of directors elected before such commencement shall retire in such manner as may be specified in the scheme and such directors shall not be entitled to claim any compensation for the premature retirement of their term of office.

Section 9 (3A): The Directors to be nominated under clause (h) or to be elected under clause (i) of subsection (3) shall-

(a) have special knowledge or practical experience in respect of one or more of the following matters namely,- (i) agricultural and rural economy, (ii) banking, (iii) co-operation, (iv) economics, (v) finance, (vi) law, (vii) small scale industry, (viii) any other matter the special knowledge of, and practical experience in, which would, in the opinion of the Reserve Bank, be useful to the corresponding new bank;

(b) represent the interests of depositors; or

(c) represent the interest of farmers, workers and artisans.

Section 9 (3AA): Without prejudice to the provisions of sub section (3A) and notwithstanding anything to the contrary contained in this Act or in any other law for the time being in force, no person shall be eligible to be elected as director under clause (i) of sub section (3) unless he is a person having fit and proper status based upon track record, integrity and such other criteria as the Reserve Bank may notify from time to time in this regard.
Section 9 (3AB): The Reserve Bank may also specify in the notification issued under sub section (3AA), the authority to determine the fit and proper status, the manner of such determination, the procedure to be followed for such determination and such other matters as may be considered necessary or incidental thereto.

Section 9 (3B): Where the Reserve Bank is of the opinion that any Director of a corresponding new bank elected under clause (i) of sub-section (3) does not fulfill the requirements of sub-sections (3A) and (3AA), it may, after giving to such Director and the bank a reasonable opportunity of being heard, by order, remove such Director and on such removal, the Board of Directors shall co-opt any other person fulfilling the requirements of sub-sections (3A) and (3AA) as a Director in place of the person so removed till a Director is duly elected by the shareholders of the corresponding new bank in the next annual general meeting and the person so co-opted shall be deemed to have been duly elected by the shareholders of the corresponding new bank as a Director.

(C) Banking Regulation Act, 1949 (BR Act): The law relating to the banking is governed by the BR Act 1949. Section 2 of the BR Act provides that the provisions of this Act shall be in addition to, and not, save as hereinafter expressly provided, in derogation of the Companies Act, 1956 (now CA 2013), and any other law for the time being in force.

Section 35 of the BR Act gives a right to RBI to undertake the inspection of any banking company. RBI has also got powers by virtue of section 35A of the BR Act, to give directions to the banking company.

Board of Directors to include persons with professional or other experience: Section 10A of the BR Act provides that:

(1) Notwithstanding anything contained in any other law for the time being in force, every banking company,—

(a) in existence on the commencement of Sec. 3 of the Banking Laws (Amendment) Act, 1968 (59 of 1968), or

(b) which comes into existence thereafter,

shall comply with the requirements of this section:

Provided that nothing contained in this sub-section shall apply to a banking company referred to in Cl.(a) for a period of three months from such commencement.

(2) Not less than fifty-one per cent of the total number of members of the Board of Directors of a banking company shall consist of persons, who—

(a) shall have special knowledge or practical experience in respect of one or more of the following matters, namely:

(i) accountancy, (ii) agriculture and rural economy, (iii) banking, (iv) co-operation, (v) economics, (vi) finance, (vii) law, (viii) small-scale industry, (ix) any other matter, the special knowledge of, and practical experience in, which would, in the opinion of the Reserve Bank, be useful to the banking company:

Provided that out of the aforesaid number of directors, not less than two shall be persons having special knowledge or practical experience in respect of agriculture and rural economy, co-operation or small-scale industry; and

(b) shall not—
(1) have substantial interest in, or be connected with, whether as employee, manager or managing agent,—

(i) any company, not being a company registered under Sec. 25 of the Companies Act, 1956 (1 of 1956), or

(ii) any firm, which carries on any trade, commerce or industry and which, in either case, is not a small-scale industrial concern, or

(2) be proprietors of any trading commercial or industrial concern, not being a small-scale industrial concern.

2-A Notwithstanding anything to the contrary contained in the Companies Act, 1956 (1 of 1956), or in any other law for the time being in force,—

(i) no director of a banking company, other than its Chairman or whole-time director, by whatever name called, shall hold office continuously for a period exceeding eight years;

(ii) a Chairman or other whole-time director of a banking company who has been removed from office as such Chairman or whole time director, as the case may be, under the provisions of this Act, shall also cease to be a director of the banking company and shall also not be eligible to be appointed as a director of such banking company, whether by election or co-option or otherwise, for a period of four years from the date of his ceasing to be the Chairman or whole-time director, as the case may be.

(3) If, in respect of any banking company, the requirements, as laid down in sub-section (2) are not fulfilled at any time, the Board of Directors of such banking company shall re-constitute such Board so as to ensure that the said requirements are fulfilled.

(4) If, for the purpose of re-constituting the Board under sub-section (3) it is necessary to retire any director or directors, the Board may, by lots drawn in such manner as may be prescribed, decide which director or directors shall cease to hold office and such decision shall be binding on every director of the Board.

(5) Where the Reserve Bank is of opinion that the composition of the Board of Directors of a banking company is such that it does not fulfil the requirements of sub-section (2), it may, after giving to such banking company reasonable opportunity of being heard, by an order in writing, direct the banking company to so reconstitute its Board of Directors as to ensure that the said requirements are fulfilled and, if within two months from the date of receipt of that order, the banking company does not comply with the directions made by the Reserve Bank, that bank may, after determining by lots drawn in such manner as may be prescribed, the person who ought to be removed from the membership of the Board of Directors, remove such person from the office of the director of such banking company and with a view to complying with the provisions of sub-section (2), appoint a suitable person as a member of the Board of Directors in the place of the person so removed whereupon the person so appointed shall be deemed to have been duly elected by banking company as its director.

(6) Every appointment, removal or reconstitution duly made and every election duly held, under this section shall be final and shall not be called into question in any Court.

(7) Every director elected or, as the case may be, appointed under this section shall hold office until the date upto which his predecessor would have held office, if the election had not been held, or, as the case may be, the appointment had not been made.

(8) No act or proceeding of the Board of Directors of a banking company shall be invalid by reason only of
any defect in the composition thereof or on the ground that it is subsequently discovered that any of its members did not fulfil the requirements of this section.

Banking company to be managed by whole-time Chairman:

Section 10B of BR Act provides that:

(1) Notwithstanding anything contained in any law for the time being in force or in any contract to the contrary, every banking company in existence on the commencement of the Banking Regulation (Amendment) Act, 1994, or which comes into existence thereafter shall have one of its directors, who may be appointed on a whole-time or a part-time basis as Chairman of its Board of Directors, and where he is appointed on a whole-time basis, as Chairman of its Board of Directors, he shall be entrusted with the management of the whole of the affairs of the banking company: Provided that the Chairman shall exercise his powers subject to the superintendence, control and direction of the Board of directors. Provided further that nothing in this sub-section shall apply to a banking company in existence on the commencement of the said section for a period of three months from such commencement. (1-A) Where a Chairman is appointed on a part-time basis,—

(i) such appointment shall be with the previous approval of the Reserve Bank and be subject to such conditions as the Reserve Bank may specify while giving such approval;

(ii) the management of the whole of the affairs of such banking company shall be entrusted to a managing director who shall exercise his powers subject to the Superintendence, control and direction of the Board of directors.

(2) Every Chairman of the Board of Directors who is appointed on a whole-time basis and every managing director of a banking company shall be in the whole-time employment of such company and shall hold office for such period, not exceeding five years, as the Board of Directors may fix, but shall, subject to the provisions of the section, be eligible for re-election or re-appointment:

Provided that nothing in this sub-section shall be construed as prohibiting a Chairman from being a director of a subsidiary of the banking company or a director of a company registered under Sec. 25 of the Companies Act, 1956 (1 of 1956).

(3) Every person holding office on the commencement of Sec. 3 of the Banking Laws (Amendment) Act, 1968 (58 of 1968), as managing director of the banking company shall—

(a) if there is a Chairman of its Board of Directors, vacate office on such commencement, or

(b) if there is no Chairman of its Board of Directors, vacate office on the date on which the Chairman of its Board of Directors is elected or appointed in accordance with the provisions of this section.

(4) Every Chairman who is appointed on a whole-time basis and every Managing Director of a banking company appointed under sub-section (1-A) shall be a person who has special knowledge and practical experience of—

(a) the working of a banking company, or of the State Bank of India or any subsidiary bank or financial institution; or

(b) financial, economic or business administration:

Provided that a person shall be disqualified for being 'Chairman who is appointed on a whole-time basis as a Managing Director, if he—

(a) is a director of any company other, than a company referred to in the proviso to sub-section (2); or

(b) is a partner of any firm which carries on any trade, business or industry; or
(c) has substantial interest in any other company or firm; or
(d) is a director, manager, managing agent, partner or proprietor of any trading, commercial or industrial concern; or
(e) is engaged in any other business or vocation.

(5) A Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director of a banking company may, by writing under his hand addressed to the company, resign his office.

(5-A) A Chairman of the Board of Directors appointed on a whole-time basis or Managing Director whose term of office has come to an end, either by reason of his resignation or by reason of expiry of the period of his office, shall, subject to the approval of the Reserve Bank continue in office until his successor assumes office.

(6) Without prejudice to the provisions of Sec. 36-AA, where the Reserve Bank is of opinion that any person who is, or has been elected to be, the Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director of a banking company is not a fit and proper person to hold such office, it may, after giving to such person and to the banking company a reasonable opportunity of being heard, by order in writing require the banking company to elect or appoint any other person as the Chairman of the Board of Directors who is appointed on a whole time basis or a Managing Director and if, within a period of two months from the date of receipt of such order, the banking company fails to elect or appoint a suitable person as the Chairman of the Board of Directors, who is appointed on a whole-time basis or a Managing Director the Reserve Bank may, by order, remove the first-mentioned person from the office of the Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director of the banking company and appoint a suitable person in his place whereupon the person so appointed shall be deemed to have been duly elected or appointed, as the case may be, as the Chairman of the Board of Directors appointed on a whole-time basis or Managing Director of such banking company and any person elected or appointed as chairman on a whole-time basis or managing director under this sub-section shall hold office for the residue of the period of office of the person in whose place he has been so elected or appointed.

(7) The banking company and any person against whom an order of removal is made under sub-section (6) may, within thirty days from the date of communication to it or to him of the order, prefer an appeal to the Central Government and the decision of the Central Government thereon, and subject thereto, the order made by the Reserve Bank under sub-section (6), shall be final and shall not be called into question in any Court.

(8) Notwithstanding anything contained in this section, the Reserve Bank may, if in its opinion it is necessary in the public interest so to do, permit the Chairman of the Board of Directors who is appointed on a whole-time basis or the Managing Director to undertake such part-time honorary work as is not likely to interfere with his duties as such Chairman or managing director.

(9) Notwithstanding anything contained in this section, where a person appointed on a whole-time basis, as Chairman of the Board of Directors or Managing Director dies or resigns or is by infirmity or otherwise rendered incapable of carrying out his duties or is absent on leave or otherwise in circumstances not involving the vacation of his office, the banking company may, with the approval of the Reserve Bank, make suitable arrangements for carrying out the duties of Chairman or Managing Director for a total period not exceeding four months.

**Power of Reserve Bank to appoint Chairman of a banking company:** Section 10BB of BR Act provides that:

(1) Where the office of the Chairman of the Board of Directors appointed on a whole-time basis or a
Managing Director of a banking company is vacant, the Reserve Bank may, if it is of opinion that the continuation of such vacancy is likely to adversely affect the interest of the banking company, appoint a person, eligible under sub-section (4) of Sec. 10-B to be so appointed, to be the Chairman of the banking company and where the person so appointed is not a director of such banking company, he shall, so long as he holds the office of the Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director, be deemed to be a director of the banking company.

(2) The Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director so appointed by the Reserve Bank shall be in the whole-time employment of the banking company and shall hold office for such period not exceeding three years, as the Reserve Bank may specify, but shall, subject to other provisions of this Act, be eligible to re-appointment.

(3) The Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director so appointed by the Reserve Bank shall draw from the banking company such pay and allowances as the Reserve Bank may determine and may be removed from office only by the Reserve Bank.

(4) Save as otherwise provided in this section, the provisions of Sec. 10-B shall, as far as may be, apply to the Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director appointed by the Reserve Bank under sub-section (1) as they apply to the Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director appointed by the banking company.

Chairman and certain directors not to be required to hold qualification shares: Section 10 C of the BR Act provides that Chairman of the Board of Directors who is appointed on a whole-time basis or a Managing Director] of a banking company by whomsoever appointed] and a director of a banking company (appointed by the Reserve Bank under Sec. 10-A shall not be required to hold qualification shares in the banking company.

(D) SEBI’s (LODR) Regulations, 2015: Many of banking companies are listed with the stock exchanges. The banks listed with the stock exchange have to adhere to the requirement of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Thus, we have seen that the banking companies are governed by the BR Act, have to follow the directions of the RBI, Special Act under which they have been incorporated or under the Companies act and if listed with the stock exchange, have to adhere with the listing requirements too, except where the provisions are not in conformity with directives of Reserve Bank of India or the Act as applicable to a respective bank.

Ganguly Committee Recommendations on Corporate Governance in Banks

The RBI vide its circular number DBOD. No. BC.-116/08.139.001/2001-02 dated 20th June 2002, circulated to all scheduled commercial banks, a Report of the Consultative Group of Directors of Banks/Financial Institutions (Dr. Ganguly Group) - Implementation of recommendations. The RBI through this circular urged the banks to place the Report as well as the list of recommendations enclosed in circular before the Board of Directors of respective banks. Based on the decision taken by the Board, these recommendations be adopted and implemented in banks.

The list of the recommendations are 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 proactive 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 subcommittees 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

Banks are the custodians of the public money. The objective of the Corporate Governance in banks is first the protections of the depositor’s interest and then to optimise the share holders/ stake holders interest.

**Basel I:** The Bank for International Settlement based Basel Committee on Banking Supervision in 1988 brought out the regulations relating to the capital requirements for banks. After the collapse of the certain hedge funds in New York and threatening to the banking system in the US, India adopted the Basel-I norms in 1992, the time when the economic reforms is said to have begun. Basel committee in Sept 1999
published a paper on Corporate Governance for banking organisations. The committee felt that it was the responsibility of the banking supervisors to ensure that there was effective corporate governance in the banking industry.

**Basel II:** The original Basel accord was found to have some deficiencies and to remove it, the first version of the Basel II came out in 1999 and after widely debate, it finally came out in June 2004. The Basel II rests on three pillars and the overall goal of it was to promote adequate capitalisation of banks and to encourage improvements in risk management and strengthening the stability of the financial system.

**Basel III:** Basel Committee on Banking Supervision (BCBS) released comprehensive reform package entitled “Basel III: A global regulatory framework for more resilient banks and banking systems” (known as Basel III capital regulations) in December 2010. Basel III reforms strengthen the bank-level i.e. micro prudential regulation, with the intention to raise the resilience of individual banking institutions in periods of stress. Besides, the reforms have a macro prudential focus also, addressing system wide risks, which can build up across the banking sector, as well as the procyclical amplification of these risks over time. Reserve Bank issued Guidelines based on the Basel III reforms on capital regulation on May 2, 2012, to the extent applicable to banks operating in India. The Basel III capital regulation has been implemented from April 1, 2013 in India in phases and it will be fully implemented as on March 31, 2019.

A consultative document of guidelines on Corporate Governance for banks was released by the Basel Committee on Banking Supervision in October 2014 and comments were invited by the central banks of the countries. Once the comments received from all the central baking authority is debated and deliberated, the Basel Committee will circulate to the member banks for its implementation.

The principles of corporate governance of this consultative document are as under:

- **Principle 1:** Board's overall responsibilities: he 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, incentive compensation 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 that there is 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’s operational structure and the risks that it poses.

- **Principle 6:** Risk management: 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 behaviour.

• **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.

**Corporate Governance in Insurance Companies**

The Insurance Regulatory and Development Authority (IRDA) has outlined in general terms, governance responsibilities of the Board in the management of the insurance functions under various Regulations notified by it covering different operational areas. These guidelines are in addition to provisions of the Companies Act, 2013, Insurance Act, 1938 and requirement of any other laws or regulations framed thereunder. Where any provisions of these guidelines appear to be in conflict with the provisions contained in any law or regulations, the legal provisions will prevail.

The IRDA issued a circular number IRDA/F&A/ CIR/025/2009-10, dated 5th August, 2009 on Corporate Governance. This circular contains the detailed guidelines relating to the Corporate governance for insurance companies. The IRDA further issued circular number IRDA/ F&I/CIR/ F&A/014/01/2010 dated 29th January, 2010 titled as amendment No.1 (of original circular dated 5th August, 2009). Further on 14th October, 2014, the IRDA constituted a working group on harmonizing Corporate Governance Guidelines and Disclosures with the Companies Act, 2013, the outcome of same is yet to come.

The gist of the existing Corporate Government guidelines are given below. The guidelines accordingly address the various requirements broadly covering the following major structural elements of Corporate Governance in insurance companies:-

- Governance structure
- Board of Directors
- Control functions
- Senior management:
  - CEO & other senior functionaries
  - Role of Appointed Actuaries
  - External audit – Appointment of Statutory Auditors
- Disclosures
- Outsourcing
- Relationship with stakeholders
- Interaction with the Supervisor
- Whistle blowing policy

Governance Structure:

(i) General: Currently, the private insurers in India are yet to go public and get their shares listed on the stock exchanges. The composition of the Boards of the Public Sector Undertakings in the insurance sector is also laid down by the Government of India. It is relevant to observe here that the Corporate Governance requirements of companies listed on the Stock Exchanges have evolved over time and are outlined in Clause 49 of the Listing Agreement of the Stock Exchanges. However, since the Indian insurance companies are as yet unlisted, the Authority advises all insurers to familiarize themselves with Corporate Governance structures and requirements appropriate to listed entities. The companies are also well advised to initiate necessary steps to address the extant “gaps” that are so identified to facilitate smooth transition at the time of their eventual listing in course of time.

(ii) Varying structures of the Board: Subject to the above, the insurance companies presently could have different structures with the Board of Directors headed by a Full-Time or Part-Time Chairman with distinct executive and oversight responsibilities among the other Directors and Senior Management. 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. Such insurers should nevertheless strive to maintain consistency in policies and practices in order to reinforce controls across the group.

Board of Directors:

(i) Composition:

- The Insurance Act stipulates that the insurance companies in India would be public companies and hence, would require a properly constituted Board.

- Insurers should ensure that the Board consists 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. The size and composition should ensure that they collectively provide knowledge, skills experience and commitment along with independence. Further, the Board Members should be in a position to dedicate sufficient time
and commitment to fulfilling their responsibilities.

- It is expected that the shareholders of the companies elect or nominate Directors from various areas of financial and management expertise such as accountancy, banking, insurance, finance, 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:
  
  o The Board of Directors and Senior Management 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.
  
  o 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 significant number of “Independent Directors” (as laid down in the Listing Agreement). The optimum contribution of Independent and Non-Executive Directors enhances the quality of business judgment and benefits the shareholders and policyholders. This is especially important in respect of insurance companies under conglomerate structure and where there is potential scope for transfer of risks and conflicts of interests that affect the group entities. At a minimum, where the company has a non-executive Chairman, at least one third of the directors should be independent and in other cases at least fifty percent of the directors should be independent. While the above intention is desirable and would facilitate smooth transition on the listing of the companies, the companies should have a minimum of two independent directors so long as they are unlisted.

- Similarly, where the Chairman of the Board is non-executive, the Chief Executive Officer should be a whole time director of the Board.

- As a matter of prudence, not more than one member of a family, or a close relative as defined in the Companies Act or an associate (partner, director, etc.,) should be on the Board of an Insurer as ‘Independent Director’.

(ii) The Role and responsibility of the Board and their Discharge: The Board would primarily concentrate on the direction, control and governance of the insurer and in particular should articulate and commit to a corporate philosophy and governance that will shape the level of risk adoption, standards of business conduct and ethical behaviour of the company at the macro levels. The Board should also set clear and transparent policy framework for translation of the corporate objectives. The Board can delegate its authority to the Board Committees in the discharge of this responsibility but such delegation does not absolve the Board from its primary responsibilities. In this regard, the Board should seek detailed and transparent information flow from the senior management through well documented agenda notes and also devise appropriate systems to serve as effective monitoring arrangements. As the Boards generally do not meet at frequent intervals, it is imperative that the senior management is clearly made accountable for the two way information flow.

The structure of the Board of Directors should be oriented to setting-up of objectives to meet the expectations of various stakeholders, strategies for their fulfillment and for monitoring the achievements. The insurers need to consider interests of all stakeholders, and especially their policyholders as a specific group. Further, since there could arise a conflict of interest amongst the various stakeholders, a key board function is to establish strategies and policies that define ethical individual and corporate behaviour and
ongoing, effective processes that ensure adherence to these strategies and policies. 

Thus, with a view to being effective, the Board in active consultation with the Management should set strategies and policies to address, at the minimum, a broad range of areas, as indicated below. There should concurrently be arrangements to review the policies from time to time to ensure that they are dynamic.

- Overall direction of the business of the insurer, including projections on the capital requirements, revenue streams, expenses and the profitability. While laying down the projections, the Board must address the expectations of the shareholders and the policyholders.
- obligation to fully comply with the Insurance Act and the regulations framed thereunder, and other statutory requirements applicable to it;
- addressing conflicts of interest;
- ensuring fair treatment of policyholders and employees;
- ensuring information sharing with and disclosures to stakeholders, including investors, policyholders, employees, the regulators, consumers, financial analysts and/or rating agencies.
- establishing channels for encouraging and facilitating employees raising concerns or reporting a possible breach of law or regulations, with appropriate measures to protect against retaliation against reporting employees;
- developing a corporate culture that recognizes and rewards adherence to ethical standards.

(iii) Fit and Proper Criteria: In line with the international and domestic norms, the Directors of insurance companies have to meet the “fit and proper” criteria. The criteria to be satisfied, at a minimum, would relate to integrity demonstrated in personal behaviour and business conduct, soundness of judgment and financial soundness. The Insurance Act prohibits (i) a life insurance agent to be the Director of the life insurance company; and (ii) the common directorship among life insurance companies. 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. With a view to ensuring that the Directors comply with the above requirement, a due diligence enquiry should be undertaken on the person to be appointed as Director or for the continuance of the existing Directors only after obtaining a declaration from the proposed/existing Directors in the prescribed format, at the time of their appointment/re-appointment.

It is desirable that the Boards constitute a Nomination Committee to scrutinize the declarations of intending applicants before the appointment/reappointment/election of directors by the shareholders at the General Meetings. The Nomination Committee could also make independent/ discreet references, where necessary, well in time to verify the accuracy of the information furnished by the applicant. The insurance companies are further advised that they should obtain an annual declaration from the Directors that the information provided in the declaration at the time of appointment/ re-appointment has not undergone any change subsequently and the changes, if any, are apprised by the concerned Director to the Board.

The Directors are also required to enter into a Deed of Covenant as per the format placed at Annexure 3, with the insurance company, duly approved by the Board, pursuant to their terms of appointment to ensure that there is a clear understanding of the mutual role of the company, the Directors and the Board in Corporate Governance.

(iv) Conduct of Meetings: The Board should also lay down systems that would make the Company
Secretary responsible for proper conduct of the Board meetings and with adequate time to deliberate on the major issues in detail. The Minutes should be recorded as soon as possible after the meeting and get circulated. There should be a system of familiarizing new Directors with the background of the company’s governance philosophy, duties and responsibilities of the Directors, etc. Well structured arrangements should be in place for ongoing briefing of Directors on dynamic changes in the financial sector in general and in the insurance in particular for updating the Directors through formal and informal programmes covering regulatory systems, market growth trends, future strategic plans/operations etc. The company must disclose the following in their annual report, inter alia:

(i) Number of the meetings held of the Board of Directors and Committees mandated under the 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.

(ii) Number of the meetings attended by the Directors and the members of the committee.

(iii) Detail of the remuneration paid, if any to the independent director.

(v) 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.

The responsibility for the oversight of control functions of an insurer should be entrusted to Directors possessing the appropriate integrity, competence, experience and qualifications.

For insurers within a group, appropriate and effective group-wide risk control systems should be in place in addition to the control systems at the level of the insurer. It is essential to manage risks appropriately on a group-wide basis as well as at the level of the insurer. The Boards of the respective insurers are required to lay down requisite policy framework to ensure that such risks are adequately addressed.

(vi) Delegation of Functions: 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. In particular, the following aspects need to be defined in respect of the role and functions of the Committees:

- Constitution
- Objectives
- Responsibilities
• Frequency of meeting/quorum requirements
• Appointment and removal of members
• Reporting to the Board

The company can 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, Nominations Committee, Remuneration Committee, Investment Committee and Asset-Liability Management Committee. However, the Authority advises insurers that it is mandatory to establish Audit; Investment; Risk Management: Policyholder Protection; and Asset Liability Management (in case of life insurers) Committees that have a critical role in strengthening the control environment in the company. Establishment of the other Committees is left to the option of the insurer. The role and responsibilities of the Committees would generally be as detailed below:-

(vii) Audit Committee (mandatory):

• The Audit Committee shall oversee the financial statements, financial reporting, statement of cash flow and disclosure processes both on an annual and quarterly basis. It shall set-up procedures and processes to address all concerns relating to adequacy of checks and control mechanisms.

• The Chairman of the Audit Committee should be an independent Director of the Board and should ideally be a professional Chartered Accountant or a person with strong financial analysis background. The association of the CEO in the Audit Committee should be limited to eliciting any specific information concerning audit findings.

• The Audit Committee will oversee the efficient functioning of the internal audit department and review its reports. The Committee will additionally monitor the progress made in rectification of irregularities and changes in processes wherever deficiencies have come to notice.

• The Audit Committee shall be directly responsible for the recommendation of the appointment, remuneration, performance and oversight of the work of the auditors (internal/statutory/Concurrent). In case of statutory audit, the independence of the external auditors shall be ensured (although the approval of appointment, remuneration and removal of the statutory auditors shall be done by the shareholders at the general body meeting).

• The Audit Committee shall have the oversight on the procedures and processes established to attend to issues relating to maintenance of books of account, administration procedures, transactions and other matters having a bearing on the financial position of the insurer, whether raised by the auditors or by any other person.

• The Audit Committee shall discuss with the statutory auditors before the audit commences, about the nature and scope of audit as well as have post-audit discussions to address areas of concern.

• Any additional work other than statutory/internal audit that is entrusted to the auditor or any of its associated persons or companies shall be specifically approved by the Board keeping in mind the necessity to maintain the independence and integrity of the audit relationship. All such other work entrusted to the auditor or its associates shall be specifically disclosed in the Notes to Accounts forming part of the annual accounts of the insurer.

(viii) 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 Division and wherever an appointed actuary is employed, the Appointed Actuary.
• The Committee’s role in managing the investments out of the policyholders’ funds is crucial and hence the constitution of the Investment Committee should be approved by the Board of Directors and any new appointment or removal of any member of the Investment Committee shall also be approved by the Board and be communicated to the Authority within 30 days.

• The Committee shall be responsible for laying down an overall investment policy and 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. It is also responsible for a periodic review of the Investment policy based on the performance of investments and the evaluation of dynamic market condition.

• Members of the Committee should be fully conversant with the various responsibilities cast on them by the IRDA (Investment) Regulations 2000 as amended from time to time as well as the guidelines issued on the system of risk management.

• The members of the Committee should not be solely influenced by the credit rating agencies. The committee should independently review their investment decisions duly supported by the due diligence process required to be carried out by the Investment Team.

• It shall also put in place an effective reporting system to ensure compliance with the policy set out by it apart from Internal/Concurrent Audit mechanisms for a sustained and on-going monitoring of Investment Operations.

• The IC shall at least meet once in a quarter and look into various aspects of investment operations and monitor them.

• The IC shall furnish a report to the Board on the performance of Investments at least on a quarterly basis and provide analysis of its Investment portfolio and on the future outlook to enable the Board to look at possible policy changes and strategies.

(ix) Risk Management Committee (mandatory):

It is now well recognized that the sound management of an insurer as in the case of other financial sector entities, is dependent on how well the various risks are managed across the organization. In pursuit of development of a strong risk management system and mitigation strategies, insurers shall set up a separate Risk Management Committee to lay down the company’s Risk Management Strategy. The risk management function 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. Conventionally this function is under the overall guidance and supervision of the Chief Risk Officer (CRO) with a clearly defined role. The insurers can, however, presently organize the function appropriately to the size, nature and complexity of their business keeping in view the need for operative independence of the Head of the risk management function. Broadly, the Risk Management Committee shall:

• assist the Board in effective operation of the risk management system by performing specialised analyses and quality reviews;

• maintaining a group-wide and aggregated view on the risk profile of the insurer in addition to the solo and individual risk profile;

• report to the Board details on the risk exposures and the actions taken to manage the exposures;

• advise the Board with regard to risk management decisions in relation to strategic and operational
matters such as corporate strategy, mergers and acquisitions and related matters.

(ix) Asset Liability Management Committee (mandatory for life insurers): ALM is an ongoing process of formulating, implementing, monitoring and revising strategies related to assets and liabilities to achieve an organization’s financial objectives, given the organization’s risk appetite, risk tolerances and business profile. The need for ALM cannot be over-emphasized as it lays down the framework to ensure that the insurer invests in a manner which would enable it to meet its cash flow needs and capital requirements at a future date. The responsibilities of the ALM Committee shall include:

- Setting the insurer’s risk/reward objectives and assess policyholder expectations.
- Quantifying the level of risk exposure and assessing the expected rewards and costs associated with the risk exposure.
- Formulating and implementing optimal ALM strategies and meeting risk/reward objectives. The strategies must be laid down both at product level and enterprise level.
- Laying down the risk tolerance limits.
- Monitoring risk exposures at periodic intervals and revising ALM strategies where required.
- Placing the ALM information before the Board at periodic intervals.

(x) Policyholder Protection Committee (mandatory): The Authority places significant emphasis on the protection of policyholder’s interests and on the adoption of sound and healthy market conduct practices by insurers. Towards meeting these objectives, IRDA has notified the (i) Protection of Policyholders’ Interests Regulations, 2002 and (ii) Insurance Advertisements and Disclosure Regulations, 2002. The Authority has also put in place the Guidelines on Advertisements, Promotion & Publicity of Insurance Companies and Insurance Intermediaries in May 2007. Insurers are also required to report on the number and nature of complaints to the IRDA at monthly intervals to enable IRDA to assess the governance and market conduct issues with respect to each insurer. 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 which shall directly report to the Board.

The Committee should put in place systems to ensure that policyholders have access to redressal mechanisms and shall establish policies and procedures, for the creation of a dedicated unit to deal with customer complaints and resolve disputes expeditiously.

Thus, the responsibilities of the Policyholder Protection Committee shall include:

- Putting in place proper procedures and effective mechanism to address complaints and grievances of policyholders including mis-selling by intermediaries.
- Ensure compliance with the statutory requirements as laid down in the regulatory framework.
- Review of the mechanism at periodic intervals.
- Ensure adequacy of disclosure of “material information” to the policyholders. These disclosures shall, for the present, comply with the requirements laid down by the Authority both at the point of sale and at periodic intervals.
- Review the status of complaints at periodic intervals to the policyholders.
- Provide the details of grievances at periodic intervals in such formats as may be prescribed by the Authority.
• Provide details of insurance ombudsmen to the policyholders.

• The reports of the Policyholder’s Protection Committee should be on the agenda of every Board Meeting of the company.

• Attention is drawn to para 7.4 of the guidelines on Asset Liability Management (ALM) Committee. An option is given to life insurers to make it part of the Risk Management Committee provided that the terms of reference of ALM are made part of the Risk Management Committee.

(xii) Other Committees: The other Committees which are optional, which can be set up by the Board, include the Remuneration Committee, Nomination Committee and the Ethics Committee. 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.

All the mandatory committees should meet at least four times in a year and not more than four months shall elapse between two successive meetings. The quorum shall be either two members or one third of the members of the committee whichever is greater, but in case an independent director is mandated to be in any of the Committees, he/she should be necessarily present to form the quorum.

(xii) Remuneration Committee (not mandatory): 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 IRDA. Further, the overall management costs of the insurer are also additionally governed by the limits prescribed statutorily in the Insurance Act and Rules framed there under in order to protect the interests of the policyholders.

• The setting up of a Remuneration Committee should keep the above requirements in view. Further, the envisaged role of the Committee includes the following aspects:

• The Remuneration Committee is required to determine on behalf of the Board and on behalf of the shareholders with agreed terms of reference, the insurer’s policy on specific remuneration packages and any compensation payment, for the CEO and the Executive Directors of the company.

• The remuneration package shall be closely connected with the performance objectives laid down for the senior management.

• To avoid conflicts of interest, the Remuneration Committee, which would determine the remuneration packages of the executive directors may comprise of at least three directors, all of whom should be non-executive directors, with the Chairman of the Committee being an independent director.

• The Chairman of the Remuneration Committee could be present at the Annual General Meeting, to answer the shareholders’ queries. However, it would be up to the Chairman to decide who should answer the queries.

(xiii) Nomination Committee (not mandatory): It is desirable that the Boards constitute a Nomination Committee to scrutinize the declarations of intending applicants before the appointment/ reappointment/ election of directors by the shareholders at the General Meetings. The Nomination Committee could also make independent/discreet references, where necessary, well in time to verify the accuracy of the information furnished by the applicant. The insurance companies are further advised that they should obtain an annual declaration from the Directors that the information provided in the declaration at the time of appointment/ re-appointment has not undergone any change subsequently and the changes, if any, are apprised by the concerned Director to the Board.

(xiv) Ethics Committee (not mandatory): Responsibilities of the Ethics Committee typically include:
monitoring the compliance function and the insurer’s risk profile in respect of compliance with external laws and regulations and internal policies, including the insurer’s code of ethics or conduct

- receiving reports on the above and on proactive compliance activities aimed at increasing the insurer’s ability to meet its legal and ethical obligations, on identified weaknesses, lapses, breaches or violations and the controls and other measures in place to help detect and address the same

- supervising and monitoring matters reported using the insurer’s whistle blowing or other confidential mechanisms for employees and others to report ethical and compliance concerns or potential breaches or violations

- advising the board on the effect of the above on the insurer’s conduct of business and helping the board set the correct “tone at the top” by communicating, or supporting the communication, throughout the insurer of the importance of ethics and compliance

- approving compliance programmes, reviewing their effectiveness on a regular basis and signing off on any material compliance issues or matters.

Senior Management

(i) CEO & Other Senior Functionaries: The Chief Executive Officer 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 affair in a manner which is not detrimental to the interests of the policyholders and is consistent with the policies and directions of the Board. The Board should, therefore, carry out effective due diligence to establish that the new incumbent is ‘fit and proper’ before recommending the name for Authority’s approval. In case the CEO resigns, the Authority should be kept informed of such resignation and the reasons therefor. The Insurance Act also prohibits the CEO of a life insurance company from being a Director on the Board of any other Indian insurance company/bank/investment company.

As the appointment of the CEO is made with the prior approval of the IRDA the Board should take proactive steps to decide on the continuance of CEO well in time before the expiry of his tenure or to identify the new incumbent. The Authority requires the proposal to be submitted with the approval of the Board at least a month before the completion of the tenure of the incumbent. As a corollary, the Board should also have practices in place for succession planning for the key senior functionaries through a process of proper identification and nurturing of individuals for taking over senior management positions.

(ii) Role of Appointed Actuaries: IRDA 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.

- The insurer shall clearly set forth the 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 management. If no viable/acceptable solution is taken, then he/she has to inform IRDA.

• 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 discharge his responsibilities, he shall at all times be provided access to the information as required.

(iii) External Audit - Appointment of Statutory Auditors:
The IRDA (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 insurance company. 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.

(iv) Appointment: The statutory auditors recommended by the Audit Committee are required to be appointed at a general body meeting of the shareholders of the insurer. For the present, the statutory auditors of insurers are required to certify the insurer’s accounts on an annual basis. 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 insurer’s financial position or the organization of its administration or its accounting and of any criminal violations or material irregularities that come to his notice.

(v) Guidelines on eligibility Conditions/Qualifications: The Authority, vide Circular No: 36/7/F&A/EMPL/74/July/05 dated 25th July 2005, while discontinuing maintenance of the panel of auditors, has laid down the requirements to be complied with for a firm to be eligible to be appointed as statutory auditor of an insurance company. The guidelines provide for joint audit of each insurance company by two statutory Auditors. In order for an audit firm to be eligible to be appointed as statutory auditors the following conditions must be complied with:

• Be in continuous practice for a period of fifteen years;
• Minimum number of partners, their qualification and experience in the audit firm as employee/partner;
• At least one partner/employee should have CISA/ISA or equivalent qualification.
• One of the joint auditors may have a term of 5 years and the other 4 years in the first instance. Thereafter, the maximum duration for which an auditor can be retained is a period of five years.
• In appointment of the statutory auditors, the insurer must ensure compliance with the requirements on ‘cooling off’ period of two years on completion of the tenure of 4/5 years as the case may be.
• No Audit Firm shall carry out more than two statutory audits of Insurance Companies (Life /Non-Life/Reinsurance).

(vi) 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.

Disclosure Requirement: The IRDA (Preparations of Financial Statements) 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 insurer’s financial and operating ratios, namely, incurred claim, commission and expenses ratios.
• Actual solvency margin details vis-à-vis the required margin.
• Life insurers shall disclose policy lapse ratio.
• Financial performance including growth rate and current financial position of the insurer
• A description of the risk management architecture
• Details of number of claims intimated, disposed of and pending with details of duration
• All pecuniary relationships or transactions of the Non-Executive Directors vis-à-vis the insurer shall be disclosed in the Annual Report.
• Any other matters, which have material impact on the insurer’s financial position.

Outsourcing: The IRDA (Registration of Insurance Companies) Regulations, 2000 requires that the insurer should be able to carry on all functions in respect of insurance business including management of investments within its own organizations. An insurer shall not, therefore, outsource any of the company’s substantive functions other than those that have been explicitly permitted. Each proposal to outsource any function of the insurer as permitted by the Authority (e.g., as in the case calculation of NAV of Investments) shall be reported to IRDA before entering into the arrangement. Where the IRDA issues any guidance in the matter, it shall be complied with. All outsourcing arrangements of the company shall have the approval of the Board. 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 programmes on termination of the outsourcing arrangement. The arrangement shall be for a defined duration of not more than 3 years and should have provision for premature cancellation
without attracting penalties. The Authority would issue in due course guidelines on functions that cannot be outsourced.

The 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.

**Relationship with Stakeholders:** A stakeholder is any person, group or organization that has a direct or indirect stake in an insurer. The stakeholder can affect or be affected by the insurer’s actions, objectives and policies.

The key stakeholders in case of an insurer include shareholders, employees, policyholders and supervisors. Other stakeholders could include creditors, service providers, unions, rating agencies, equity analysts and the community at large.

The stakeholders are interested in the operations of the insurers in terms of:

- its profitability and thus its capacity to provide a return on capital to shareholders, hire employees, expand its operations and contribute to economic and social activity
- its ability to meet its obligations to the various stakeholders as they come due, thereby also promoting trust and confidence in the financial system

Towards protecting the interests of the various stakeholders the insurer must ensure complete transparency in operations and make periodic disclosures. The disclosures stipulations must at the minimum address the following:

- financial statements accurately and fairly represent the financial condition of the insurer; and
- the insurer is running its business soundly and will be viable over the long term.
- In particular, the disclosure requirements of the participating policyholders and the unit linked policyholders must be duly addressed.

**Interaction with the Supervisor:** Effective corporate governance practices in the office of the insurer will enable IRDA to have greater confidence in the work and judgement of an insurer’s board, senior management and control functions.

In assessing the governance practices in place, the IRDA would:

- Seek confirmation that the insurer 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 insurers’ internal reporting, risk management, audit and control functions;
- evaluate the effects of the insurer’s group structure on the governance strategies;
- assess the adequacy of governance processes in the area of crisis management and business continuity.

The IRDA would at periodic intervals bring to the attention of the Board and senior management, concerns which have been detected through supervisory activities.
Reporting to IRDA: 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 six months from the date of these guidelines. It is expected that all the arrangements would be in place to ensure full compliance with the guidelines from the financial year 2010-2011. Where such compliance is not possible for any specific reason, the insurer should write to the IRDA for further guidance.

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

Annual report of the insurers will have a separate certification from the compliance officer in the prescribed format.

Whistle Blowing Policy: The insurers are well advised to put in place a “whistle blowing” 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 external 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 IRDA if they are aware that the insurer has failed to take appropriate steps to rectify a matter which has a material adverse effect on its financial condition. This would enable the IRDA to take prompt action before policyholders’ interests are undermined.

Corporate Governance in Public Sector Enterprises

Department of Public Enterprises (DPE) is the nodal department for issuing the corporate governance guidelines for the Public Sector Enterprises for both at center and state level. Since Government is the major shareholder in Public Sector Undertakings (PSUs)/Central Public Sector Enterprises (CPSEs), it is responsible to set the high standard of governance to be followed by these public sector enterprises. As the government’s disinvestment strategy gathers momentum, there is a genuine need to improve the levels of transparency, and accountability within PSUs.

To bring in more transparency and accountability in the functioning of CPSEs, the Government in June, 2007 introduced, for an experimental period of one year, the Guidelines on Corporate Governance for CPSEs. These Guidelines were of voluntary nature. Since the issue of these guidelines, the CPSEs have had the opportunity to implement them for the whole of the financial year 2008-09. These Guidelines have been modified and improved upon based on the experience gained during the experimental period of one year. The Government have felt the need for continuing the adoption of good Corporate Governance Guidelines by CPSEs for ensuring higher level of transparency and decided to make these Guidelines mandatory and applicable to all CPSEs. Accordingly, revised Guidelines on Corporate Governance for Central Public Sector Enterprises was issued by DPE in 2010.

Apart from these instructions of DPE, the CPSEs are governed by the Companies Act, 2013 and regulations
of various authorities like Comptroller and Auditor General of India (C&AG), Central Vigilance Commission (CVC), Administrative Ministries, other nodal Ministries, etc. In case of Listed CPSEs the Listing Agreement would also be applicable in addition to other applicable laws and DPE Guidelines. For the purpose of DPE Guidelines on Corporate Governance, CPSEs have been categorised into two groups, namely, (i) those listed on the Stock Exchanges; (ii) those not listed on the Stock Exchanges.

**CPSEs listed on Stock Exchanges:** In so far as listed CPSEs are concerned, they have to follow the SEBI Guidelines on Corporate Governance. In addition, they shall follow those provisions in these Guidelines which do not exist in the SEBI Guidelines and also do not contradict any of the provisions of the SEBI Guidelines.

**Unlisted CPSEs:** Each CPSE should strive to institutionalize good Corporate Governance practices broadly in conformity with the SEBI Guidelines. The listing of the non-listed CPSEs on the stock exchanges may also be considered within a reasonable time frame to be set by the Administrative Ministry concerned in consultation with the CPSEs concerned. The non-listed CPSEs shall follow the Guidelines on Corporate Governance on a mandatory basis.

DPE guidelines on Corporate Governance provide following governance parameters:

- Board of Directors
- Audit Committee
- Remuneration Committee
- Subsidiary Companies
- Disclosures
- Report, Compliance and Schedule of Implementation

While listed PSUs are required to comply with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, it is also mandatory for all Central Public Sector Enterprises (CPSEs) to comply with the corporate governance norms rolled out by the Department of Public Enterprises.

**Salient features of Guidelines on Corporate Governance for Central Public Sector Enterprises 2010:**

(a) **Board of Directors:**

*Composition of Board of Directors:* The Board of Directors of the company shall have an optimum combination of Functional, Nominee and Independent Directors. The number of Functional Directors (including CMD/MD) should not exceed 50% of the actual strength of the Board. The number of Nominee Directors appointed by Government/other CPSEs shall be restricted to a maximum of two. In case of a CPSE listed on the Stock Exchanges and whose Board of Directors is headed by an Executive Chairman, the number of Independent Directors shall be at least 50% of Board Members; and in case of all other CPSEs (i.e. listed on Stock Exchange but without an Executive Chairman, or not listed CPSEs), at least one-third of the Board Members should be Independent Directors.

*Part-time Directors’ compensation and disclosures:* All fees/compensation, if any, paid to part-time Directors, including Independent Directors, shall be fixed by the Board of Directors subject to the provisions in the DPE guidelines and the Companies Act, 2013.

*Number of Board meetings:* The Board shall meet at least once in every three months and at least four such meetings shall be held every year. Further, the time gap between any two meetings should not be
more than three months. A Director shall not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a Director. Furthermore it should be a mandatory annual requirement for every Director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

**Compliance of Laws to be reviewed:** The Board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of noncompliances.

**Code of Conduct:** The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be circulated and also posted on the website of the company. All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by its Chief Executive. Guidelines and policies evolved by the Central Government with respect to the structure, composition, selection, appointment and service conditions of Boards of Directors and senior management personnel shall be strictly followed. There shall be no extravagance in expenditure on the part of Board members and senior management personnel. CPSEs executives shall be accountable for their performance in conformity with established norms of conduct. Any external/internal changes made from time to time, due to addition of or amendment to laws/regulatory rules, applicable to CPSEs, need to be dealt with carefully by the respective Boards/senior management personnel.

**Functional Role Clarity between Board of Directors and Management:** A clear definition of the roles and the division of responsibilities between the Board and the Management is necessary to enable the Board to effectively perform its role. The Board should have a formal statement of Board Charter which clearly defines the roles and responsibilities of the Board and individual Directors. The Board of each CPSE may be encouraged to articulate its Corporate Governance objectives and approach (within the broad parameters of these guidelines and the general perception of business risk) to satisfy the expectations of its majority shareholders and other stakeholders.

**Risk Management:** Enterprise risk management helps management in achieving CPSE’s performance and profitability targets. It helps to ensure effective reporting and compliance with laws and regulations, and helps avoid damage to the entity’s reputation and associated consequences. Considering the significance of risk management in the scheme of corporate management strategies, its oversight should be one of the main responsibilities of the Board/Management. The Board should ensure the integration and alignment of the risk management system with the corporate and operational objectives and also that risk management is undertaken as a part of normal business practice and not as a separate task at set times.

**Training of Directors:** The company concerned shall undertake training programme for its new Board members (Functional, Government, Nominee and Independent) in the business model of the company including risk profile of the business of company, responsibility of respective Directors and the manner in which such responsibilities are to be discharged. They shall also be imparted training on Corporate Governance, model code of business ethics and conduct applicable for the respective Directors.

**(b) Audit Committee**

**Qualified and Independent Audit Committee:** A qualified and independent Audit Committee shall be set up, giving the terms of reference. The Audit Committee shall have minimum three Directors as members. Two-thirds of the members of audit committee shall be Independent Directors. The Chairman of the Audit Committee shall be an Independent Director. All members of Audit Committee shall have knowledge of financial matters of Company, and at least one member shall have good knowledge of accounting and related financial management expertise. The Chairman of the Audit Committee shall be present at Annual
General Meeting to answer shareholder queries; provided that in case the Chairman is unable to attend due to unavoidable reasons, he may nominate any member of the Audit Committee.

The Audit Committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the Committee. The Audit Committee may also meet without the presence of any executives of the company. The Finance Director, Head of Internal Audit and a representative of the Statutory Auditor may be specifically invited to be present as invitees for the meetings of the Audit Committee as may be decided by the Chairman of the Audit Committee. The Company Secretary shall act as the Secretary to the Audit Committee.

**Role of Audit Committee:** The role of the Audit Committee shall include the following:

- Oversight of the company’s financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
- Recommending to the Board the fixation of audit fees.
- Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
- Reviewing, with the management, the annual financial statements before submission to the Board for approval, with particular reference to: (a) Matters required to be included in the Directors’ Responsibility Statement to be included in the Board’s report (b) Changes, if any, in accounting policies and practices and reasons for the same; (c) Major accounting entries involving estimates based on the exercise of judgment by management; (d) Significant adjustments made in the financial statements arising out of audit findings; (e) Compliance with legal requirements relating to financial statements; (f) Disclosure of any related party transactions; and (g) Qualifications in the draft audit report.
- Reviewing, with the management, the quarterly financial statements before submission to the Board for approval.
- Reviewing, with the management, performance of internal auditors and adequacy of the internal control systems.
- Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure, coverage and frequency of internal audit.
- Discussion with internal auditors and/or auditors any significant findings and follow up there on.
- Reviewing the findings of any internal investigations by the internal auditors/auditors/agencies into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board.
- Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
- To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
- To review the functioning of the Whistle Blower Mechanism.
- To review the follow up action on the audit observations of the C&AG audit.
- To review the follow up action taken on the recommendations of Committee on Public Undertakings (COPU) of the Parliament.
- Provide an open avenue of communication between the independent auditor, internal auditor and the Board of Directors.
Review all related party transactions in the company. For this purpose, the Audit Committee may designate a member who shall be responsible for reviewing related party transactions.

Review with the independent auditor the co-ordination of audit efforts to assure completeness of coverage, reduction of redundant efforts, and the effective use of all audit resources.

Consider and review the following with the independent auditor and the management: (i) The adequacy of internal controls including computerized information (ii) system controls and security, and -Related findings and recommendations of the independent auditor and internal auditor, together with the management responses.

Consider and review the following with the management, internal auditor and the independent auditor: (i) Significant findings during the year, including the status of previous audit recommendations (ii) -Any difficulties encountered during audit work including any restrictions on the scope of activities or access to required information.

**Powers of Audit Committee:** Commensurate with its role, the Audit Committee should be invested by the Board of Directors with sufficient powers, which should include the following:

- To investigate any activity within its terms of reference.
- To seek information on and from any employee.
- To obtain outside legal or other professional advice, subject to the approval of the Board of Directors.
- To secure attendance of outsiders with relevant expertise, if it considers necessary.
- To protect whistle blowers.

**Meeting of Audit Committee:** The Audit Committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the Audit Committee whichever is greater, but a minimum of two independent members must be present.

**Review of information by Audit Committee:** The Audit Committee shall review the following information:

- Management discussion and analysis of financial condition and results of operations;
- Statement of related party transactions submitted by management;
- Management letters/letters of internal control weaknesses issued by
  - the statutory auditors;
- Internal audit reports relating to internal control weaknesses;
- The appointment and removal of the Chief Internal Auditor shall be placed before the Audit Committee; and Certification/declaration of financial statements by the Chief Executive/Chief Finance Officer.

(c) **Remuneration Committee:** Each CPSE shall constitute a Remuneration Committee comprising of at least three Directors, all of whom should be part-time Directors (i.e Nominee Directors or Independent Directors). The Committee should be headed by an Independent Director. CPSE will not be eligible for Performance Related Pay unless the Independent Directors are on its Board. Remuneration Committee will decide the annual bonus/variable pay pool and policy for its distribution across the executives and non unionized supervisors, within the prescribed limits.

(d) **Subsidiary Companies:** At least one Independent Director on the Board of Directors of the holding company shall be a Director on the Board of Directors of its subsidiary company. The Audit Committee of the holding company shall also review the financial statements of its subsidiary company. The minutes of the
Board meetings of the subsidiary company shall be placed at the Board meeting of the holding company. The management should periodically bring to the attention of the Board of Directors of the holding company, a statement of all significant transactions and arrangements entered into by its subsidiary company.

**Explanation:** For the purpose of these guidelines, only those subsidiaries whose turnover or net worth is not less than 20% of the turnover or net worth respectively of the Holding company in the immediate preceding accounting year may be treated as subsidiary companies.

**(e) Disclosure:**

*Transactions:* A statement in summary form of transactions with related parties in the normal and ordinary course of business shall be placed periodically before the Audit Committee. Details of material individual transactions with related parties, which are not in the normal and ordinary course of business, shall be placed before the Audit Committee. Details of material individual transactions with related parties or others, which are not on an arm’s length basis should be placed before the Audit Committee, together with Management’s justification for the same.

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

**Board Disclosures – Risk management:**

- The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework. Procedure will be laid down for internal risk management also.

- The Board should implement policies and procedures which should include: (a) staff responsibilities in relation to fraud prevention and identification (b) responsibility of fraud investigation once a fraud has been identified (c) process of reporting on fraud related matters to management (d) reporting and recording processes to be followed to record allegations of fraud (e) requirements of training to be conducted on fraud prevention and identification.

**Remuneration of Directors:**

- All pecuniary relationship or transactions of the part-time Directors vis-à-vis the company shall be disclosed in the Annual Report.

- Further the following disclosures on the remuneration of Directors shall be made in the section on the Corporate Governance of the Annual Report: (a) All elements of remuneration package of all the directors i.e. salary, benefits, bonuses, stock options, pension, etc. (b) Details of fixed component and performance linked incentives, along with the performance criteria (c) Service contracts, notice period, severance fees. (d) Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

**Management:** As part of the Directors Report or as an addition thereto, a Management Discussion and Analysis Report should form part of the Annual Report. This Management Discussion and Analysis should include discussion on the following matters within the limits set by the company’s competitive position: (a) Industry structure and developments, (b) Strength and weakness (c) Opportunities and Threats (d) Segment-wise or product-wise performance (e) Outlook (f) Risks and concerns (g) Internal control systems and their adequacy (h) Discussion on financial performance with respect to operational performance (i)
Material developments in Human Resources, Industrial Relations front, including number of people employed. (j) Environmental Protection and Conservation, Technological conservation, Renewable energy developments, Foreign Exchange conservation (k) Corporate social responsibility.

Senior management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest that may have a potential conflict with the interest of the company (e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives, etc.)

Explanation: For this purpose, the term “senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the Functional Directors, including all functional heads.

Report on Corporate Governance: There shall be a separate section on Corporate Governance in each Annual Report of company, with details of compliance on Corporate Governance.

Compliance: The company shall obtain a certificate from either the auditors or practicing Company Secretary regarding compliance of conditions of Corporate Governance as stipulated in these Guidelines and Annexes. The aforesaid certificate with the Directors’ Report, which is sent annually to all the shareholders of the company, should also be included in the Annual Report. Chairman’s speech in Annual General Meeting (AGM) should also carry a section on compliance with Corporate Governance guidelines/norms and should form part of the Annual Reports of the concerned CPSE. The grading of CPSEs may be done by DPE on the basis of the compliance with Corporate Governance guidelines/norms.

Schedule of implementation: These Guidelines on Corporate Governance are now mandatory. The CPSEs shall submit quarterly progress reports, within 15 days from the close of each quarter, in the prescribed format to respective Administrative Ministries/Departments. The Administrative Ministries will consolidate the information obtained from the CPSEs and furnish a comprehensive report to the DPE by 31st May of every financial year on the status of compliance of Corporate Governance Guidelines during the previous financial year by the CPSEs under their jurisdiction. DPE will, from time to time, make suitable modifications to these Guidelines in order to bring them in line with prevailing laws, regulations, acts, etc., DPE may also issue clarifications to the concerned Administrative Ministries/CPSEs on issues relating to the implementation of these Guidelines.

Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises (effect from 1st April 2013):

There is infusion of policy content in a large measure in the revised guidelines. The expectations of the key stakeholders, including the Government, expressed in general and specific terms in this Chapter, constitute the ‘Policy statement’ on CSR and Sustainability. The earlier guidelines focussed mainly on CSR activities for external stakeholders i.e. how social causes and environmental concerns could be addressed through CSR projects funded by an earmarked budget for this purpose. Whereas, in the revised guidelines, CSR and Sustainability agenda is perceived to be equally applicable to internal stakeholders (particularly, the employees of a company), and a company’s corporate social responsibility is expected to cover even its routine business operations and activities. Accordingly, under the revised guidelines, CPSEs are expected to formulate their policies with a balanced emphasis on all aspects of CSR and Sustainability – equally with regard to their internal operations, activities and processes, as well as in their response to externalities.

Corporate Social Responsibility and Sustainable Development were treated as two separate subjects and consequently, dealt with separately for the purpose of MoU evaluation in the earlier guidelines. This reportedly posed practical difficulties for CPSEs in deciding in which category to report their sustainability
initiatives, with both the departments in the organisation making competing claims for credit for such work. Dealing with the two concepts separately does not make practical sense from the business standpoint because of their close linkage. Hence, in line with the international practice, in the revised guidelines CSR and Sustainable Development have been clubbed together in one set of guidelines for CSR and Sustainability. For the purpose of MoU evaluation, the performance of the CPSEs would be judged on the basis of the revised guidelines.

In the revised guidelines, the thrust of CSR and Sustainability is clearly on capacity building, empowerment of communities, inclusive socio-economic growth, environment protection, promotion of green and energy efficient technologies, development of backward regions, and upliftment of the marginalised and under-privileged sections of the society. Making it mandatory in the revised guidelines for CPSEs to take up at least one major project for development of a backward district has the potential of contributing significantly in the long run to socio-economic growth in all the backward regions of the country.

The revised guidelines give a clear, unequivocal message that CPSEs are expected to act in a socially responsible manner at all times. Even in their normal business activities, public sector companies should try to conduct business in a manner that is beneficial to both, business and society. They are advised not to lose sight of their social responsibility and commitment to sustainable development even in their normal business activities. Rather, they are prompted to use social responsibility and sustainability initiatives for business gains as well as social value creation through adoption of “shared value” approach, wherever possible in their routine business operations.

The revised guidelines emphatically underscore the need for the top management of the public enterprises to be passionately involved in carrying forward the agenda of corporate social responsibility and sustainability. Experience testifies that the delegation of the task of planning and implementation of activities under this policy to some officials in the company is not of much help. If the philosophy of CSR and Sustainability is to be ingrained in the DNA of the organization, and be reflected in the organizational culture and involve all employees engaged in diverse business operations and activities, it is imperative that the top management leads from the front in bringing about the required attitudinal and processual transformation. They have to demonstrate their belief in the change in order to bring about the desired change. This message is conveyed very clearly in the revised guidelines. The two-tier structure, comprising of a Board level committee headed by either the Chairman and/or Managing Director, or an Independent Director, and a group of officials headed by a senior executive of not less than one rank below the Board level – which the CPSEs are mandated to create, is expected to have the authority and influence to be able to steer the CSR and Sustainability agenda of the company.

In the revised guidelines, the utility of a baseline survey in any need assessment study before taking up a CSR and Sustainability project is recognised, but keeping in view the vocal protests of several CPSEs against making it a mandatory provision, baseline survey is not insisted upon in every case. The CPSEs have been granted the flexibility to opt for other methods, including use of their own in-house expertise and resources for need assessment studies. The only requirement insisted upon in the revised guidelines is that the CPSEs should submit credible evidence of having made a fairly accurate assessment of the needs of the stakeholders likely to be benefitted from their CSR and Sustainability activity, which would also help in making a fair estimation of the social/environmental impact after the conclusion of the activity.

As in the previous guidelines, there is provision in the revised guidelines that the unutilised budget for CSR activities planned for a year will not lapse and will, instead, be carried forward to the next year. However, in order to ensure that the CPSEs take their corporate social responsibility seriously, some new provisions have been incorporated in the revised guidelines. Henceforth, CPSEs will have to disclose the reasons for not fully utilising the budget allocated for CSR and Sustainability activities planned for each year. Besides,
the unspent amount of the budget allocated for CSR and Sustainability activities for a year will have to be spent within the next two financial years, failing which, it would be transferred to a ‘Sustainability Fund’ to be created separately for CSR and Sustainability activities.

In the previous guidelines, regardless of their size and profitability each CPSE was required to submit details of 10 projects for evaluation under MoU – 5 each for CSR and Sustainable Development, respectively. In the revised guidelines, emphasis is placed on the scalability of the projects, in terms of their size and impact, rather than on their numbers. Therefore, in the revised guidelines, CPSEs are required to submit details of only 2 projects for scrutiny for the purpose of annual MoU evaluation. Only the Maharatna companies which have larger resources for CSR & Sustainability activities will have to submit details of one additional project for evaluation. It is expected that with a reduced number of projects CPSEs will be able to spare sufficient resources for each project to ensure its viability, visibility and noticeable impact. Besides, fewer projects would be easier to implement and monitor.

In line with the same reasoning as mentioned in para above, regarding the scalability of projects, public sector enterprises are exhorted in the revised guidelines to join hands with other public sector companies for planning, implementing & monitoring mega projects for optimal use of resources and synergy of expertise and capabilities for maximum socio-economic or environmental impact.

In a radical departure from the previous guidelines which prohibited employees from being the direct beneficiaries of the CSR policies and activities of their parent company, the revised guidelines allow the employees to avail the infrastructure facilities created by their company from its CSR and Sustainability budget, provided the facilities are originally created essentially for the external stakeholders, and the use of these facilities by the company’s employees (internal stakeholders) is only incidental and confined to less than 25% of the total number of beneficiaries. This provision has been introduced to resolve the problem of several CPSEs who find themselves stuck in situations where the expenditure incurred on the construction and maintenance of their infrastructure facilities is not being treated as CSR endeavour, simply because a few of their employees also happen to be availing such facilities.

Some changes have been made in the financial component of CSR and Sustainability agenda. One, there is no separate allocation of budget for sustainable development, as was mandated earlier. Two, the slab of budgetary expenditure on CSR and Sustainability activities for the CPSEs having PAT over Rs.500 crore in the previous year, would now be from 1% - 2%. This is only a marginal change because, in any case, CPSEs are now advised to maximise their expenditure on CSR activities and move towards the higher end of their respective slabs of budget allocation for this purpose. Third, in the earlier guidelines there was a provision of a minimum expenditure of Rs.3 crores on CSR activities for CPSEs having a net profit of Rs. 100 – 500 crores. This created an anomalous situation vis-à-vis the CPSEs placed in the higher slab, having a net profit of over Rs.500 crore, for which no minimum expenditure was specified in the earlier guidelines. The requirement of a minimum expenditure of Rs.3 crore has been removed in the revised guidelines. However, these CSR guidelines and especially the suggested slabs of budgetary allocation for CSR and Sustainability activities would stand modified as and when the new Company Law brings in provisions in this regard, which would need to be followed by all companies including the CPSEs.

**Conclusion**

The Companies Act, 2013 is applicable to all companies registered under the Act. The old/new generation private sector banks are the joint stock companies and are governed by the provisions of the Company Law. However Since the Nationalized Banks are not registered under the Companies Act, the same is not applicable for them and there are separate governing statutes for nationalized banks. The banks which are listed on the Stock Exchanges (it may be old/new private sector banks as well as PSU banks) have to
adhere with the listing agreement too.

The Insurance companies are also subject to compliance with governance guidelines prescribed by IRDA in addition to other applicable legislations. The PSUs/CPSEs are subject to additional supervision and compliance of DPE/Vigilance/C&AG directives as compare to the private sector companies.

**LESSON ROUND UP**

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

- The companies listed with Stock Exchanges have to adhere to the SEBI (LODR) Regulations, 2015 in addition to the provisions of the Companies Act or the Act under which they been formed. The banks under governed by the different statutes hence the respective Acts under which they have been incorporated have to comply with that requirement along with the directives of the Regulatory Authorities (like RBI for Banks and IRDA for Insurance).

- The inception of the Corporate Governance norms may for banks may firstly be treated when the RBI accepted and published the Ganguly Committee Recommendations. Since India is also following the best practices as enunciated by the Basel Committee and adopted by the banks in India as per the directions of the RBI, the Corporate Governance Norms as suggested in Basel I, II and III has also been elaborated in the chapter.

- The Corporate Governance norms for insurance companies are governed by the IRDA guidelines.

**SELF TEST QUESTIONS**

1. What do you mean by the Corporate Governance? How the governance norms are applicable in the banks.

2. Discuss the salient features of the Ganguly Committee Report applicable to Private Sector Banks.

3. IRDA has issued the guidelines on Corporate Governance Norms for the Insurance Companies. Please mention the salient features of it.

4. Public Sector Undertakings have also to adhere the norms of the Corporate Governance. What guidelines have been issued by the Ministry in this regard?

5. Comments on the Corporate Social Responsibility.
Lesson 11
Corporate Governance Forums

LESSON OUTLINE

• Introduction
• The Institute of Company Secretaries of India
• National Foundation for Corporate Governance
• Organisation for Economic Co-operation and Development
• Institute of Directors, UK
• Commonwealth Association of Corporate Governance
• International Corporate Governance Network
• European Corporate Governance Institute
• Conference Board
• Asian Corporate Governance Association
• Corporate Secretaries International Association
• 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.

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

- 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 “Ethics, Governance and Sustainability” 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 - **SS-1: Meetings of the Board of Directors** and **SS-2: General Meetings** have been notified in the Official Gazette under Section 118 (10) of the
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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. Prior to the promulgation of the Companies Act, 2013, the secretarial standards were recommendatory in nature and ICSI had issued 10 Secretarial Standards. With the introduction of SS in the statute book 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. One of the major publications of ICSI is ‘Corporate Governance – Beyond Letters’. The revised edition of this publication is brought out regularly by incorporating the best practices of the corporates participating in the Award.

- **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. More than 2100 programmes have so far been conducted across the country. 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.

- **National Policy on Corporate Governance** - The Ministry of Corporate Affairs vide Office Memorandum dated March 7, 2012 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.

- **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 to - 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’.

**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.

**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.

**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 A Catalyst In Making India The Best In Corporate Governance Practices

Mission of NFCG

- To foster a culture for promoting good governance, voluntary compliance and facilitate effective participation of different stakeholders;
- To create a framework of best practices, structure, processes and ethics;
- To make significant difference to Indian Corporate Sector by raising the standard of corporate governance in India towards achieving stability and growth.

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.

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.

(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.

(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. The OECD was one of the first non-government organizations to spell out the principles that should govern corporates.
The OECD Steering Group on Corporate Governance co-ordinates and guides the Organisation's work on corporate governance and related corporate affairs issues, including state-owned assets, market integrity, company law, insolvency and privatisation.

The mission of OECD is to promote policies that will improve the economic and social well-being of people around the world. In order to contribute to the development of the world economy, the OECD's focus includes a growing number of other countries, in addition to its 30 members. It now shares its expertise and accumulated experience with more than 70 developing and emerging markets.

The OECD Principles of Corporate Governance has provided governments, regulators and other standard setters with an international benchmark. The OECD works closely with a large number of developing and emerging market countries. In particular, the OECD organises Regional Corporate Governance Roundtables in Asia, Latin America, Eurasia, Southeast Europe and Russia. These Roundtables have used the OECD Principles to formulate regional reform priorities and are now actively engaged in implementing these recommendations.

**OECD Principles of Corporate Governance**

The OECD Principles of Corporate Governance set out a framework for good practice which was agreed by the governments of all 30 countries that are members of the OECD. They were designed to assist governments and regulatory bodies in both OECD countries and elsewhere in drawing up and enforcing effective rules, regulations and codes of corporate governance. They also provide guidance for stock-exchanges, investors, companies and others that have a role in the process of developing good corporate governance.

The original OECD Principles were issued in 1999, they became a generally accepted standard in this area. 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.

<table>
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<tr>
<th>Principles of Corporate Governance --- OECD</th>
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<td>(a) They call on governments to have in place an effective institutional and legal framework to support good corporate governance practices.</td>
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<tr>
<td>(b) They call for a corporate governance framework that protects and facilitates the exercise of shareholders’ rights.</td>
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<td>(c) They also strongly support the equal treatment of all shareholders, including minority and foreign shareholders.</td>
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<td>(d) They recognise the importance of the role of stakeholders in corporate governance.</td>
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<td>(e) They look at the importance of timely, accurate and transparent disclosure mechanisms</td>
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<td>(f) They deal with board structures, responsibilities and procedures.</td>
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The OECD principles of Corporate Governance are currently being updated to ensure their continuing high quality relevance and usefulness taking into account recent developments in the corporate sector and capital markets. The revised draft of OECD Principles of CG is under public consultation stage and will be released soon.

**D. THE INSTITUTE OF DIRECTORS (IoD), UK**

The IoD is a non party-political business organisation established in United Kingdom in 1903. The IoD seeks to provide an environment conducive to business success.
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.

CACG Guidelines

The CACG guidelines set out 15 Principles of corporate governance aimed primarily at boards of
directors of corporations with a unitary board structure, as will most often be found in the Commonwealth. The Principles apply equally to boards of directors of all business enterprises – public, private, family owned or state-owned. The Principles are applicable to both executive and non-executive directors. The term “director” should be taken as being synonymous with any person responsible for the direction of a business enterprise. Similarly, the principles can be usefully applied to other forms of enterprise such as non-governmental organisations and agencies.

The board should:

**Principle 1** – exercise leadership, enterprise, integrity and judgment in directing the corporation so as to achieve continuing prosperity for the corporation and to act in the best interest of the business enterprise in a manner based on transparency, accountability and responsibility;

**Principle 2** – ensure that through a managed and effective process board appointments are made that provide a mix of proficient directors, each of whom is able to add value and to bring independent judgment to bear on the decision-making process;

**Principle 3** – determine the corporation’s purpose and values, determine the strategy to achieve its purpose and to implement its values in order to ensure that it survives and thrives, and ensure that procedures and practices are in place that protect the corporation’s assets and reputation;

**Principle 4** – monitor and evaluate the implementation of strategies, policies, management performance criteria and business plans;

**Principle 5** – ensure that the corporation complies with all relevant laws, regulations and codes of best business practice;

**Principle 6** – ensure that the corporation communicates with shareholders and other stakeholders effectively;

**Principle 7** – serve the legitimate interests of the shareholders of the corporation and account to them fully;

**Principle 8** – identify the corporation’s internal and external stakeholders and agree a policy, or policies, determining how the corporation should relate to them;

**Principle 9** – ensure that no one person or a block of persons has unfettered power and that there is an appropriate balance of power and authority on the board which is, inter alia, usually reflected by separating the roles of the chief executive officer and Chairman, and by having a balance between executive and non-executive directors;

**Principle 10** – regularly review processes and procedures to ensure the effectiveness of its internal systems of control, so that its decision-making capability and the accuracy of its reporting and financial results are maintained at a high level at all times;

**Principle 11** – regularly assess its performance and effectiveness as a whole, and that of the individual directors, including the chief executive officer;

**Principle 12** – appoint the chief executive officer and at least participate in the appointment of senior management, ensure the motivation and protection of intellectual capital intrinsic to the corporation, ensure that there is adequate training in the corporation for management and employees, and a succession plan for senior management;

**Principle 13** – ensure that all technology and systems used in the corporation are adequate to properly run the business and for it to remain a meaningful competitor;

**Principle 14** – identify key risk areas and key performance indicators of the business enterprise and
monitor these factors;

**Principle 15** – ensure annually that the corporation will continue as a going concern for its next fiscal year.

**F. INTERNATIONAL CORPORATE GOVERNANCE NETWORK (ICGN)**

The International Corporate Governance Network (“ICGN”) is a not-for-profit company limited by guarantee and not having share capital under the laws of England and Wales founded in 1995. 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 were released in 2014.

**G. THE 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.

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 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.

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. THE 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.

#### 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.
Note: 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.iод.com
- http://www.icgn.org/
- www.ecgi.org/
- http://www.conference-board.org/
- http://www.acga-asia.org/
- www.csiaorg.com

LESSON ROUND UP

- The ICSI Vision and Mission; The ICSI Philosophy on Corporate Governance; The ICSI's approach to Corporate Governance provides the solution to the development issues.

- The National Foundation for Corporate Governance - NFCG endeavours to build capabilities in the area of research in corporate governance and to disseminate quality and timely information to concerned stakeholders; The NFCG Mission; The internal governance structure of NFCG.

- OECD - The OECD Principles of Corporate Governance set out a framework for good practice which was agreed by the governments of all 30 countries that are members of the OECD. The OECD Principles covers six areas.

- The IoD is a non party-political business organisation established in United Kingdom in 1903. The IoD seeks to provide an environment conducive to business success.

- The Commonwealth Association of Corporate Governance (CACG) was established in 1998 with the objective of promoting the best international standards on corporate governance throughout the Commonwealth as a means to achieve global standards of business efficiency, commercial probity and effective economic and social development.

- The International Corporate Governance Network ("ICGN") is a not-for-profit company limited by guarantee under the laws of England and Wales. The Network’s mission is to develop and encourage adherence to corporate governance standards and guidelines, and to promote good corporate governance worldwide.

- The European Corporate Governance Institute (ECGI) was founded in 2002. It has been established to improve corporate governance through fostering independent scientific research and related activities.

- The Conference Board was established in 1916 in the United States of America. The Conference Board governance programs 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**

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
LESSON OUTLINE

- Introduction
- Corporate Governance in Australia
- Corporate Governance in Singapore
- Corporate Governance in South Africa
- Corporate Governance in United Kingdom
- Corporate Governance Codes – Globally
- Corporate Governance at UK, Singapore, Australia, South Africa and India – A Comparative table
- Lesson Round-up
- Self Test Questions

LEARNING OBJECTIVES

Corporate governance can be considered as an environment of trust, ethics, moral values and confidence – as a synergic effort of all the constituents of society – that is the stakeholders, including government; the general public etc; professional, service providers – and the corporate sector. One of the consequences of a concern with the actions of an organisation, and the consequences of those actions, has been an increasing concern with corporate governance. After big corporate scandals, corporate governance has become central to most companies. Corporate governance is therefore a current buzzword the world over. One of the main issues, which have been occupying the minds of business managers, accountants and auditors, investment managers and government officials – again all over the world – is that of corporate governance. It has gained tremendous importance in recent years.

There is a considerable body of literature which considers the components of a good system of governance and a variety of frameworks exist or have been proposed. The objective of this study lesson is to provide the students an international perspective in the emerging areas of Corporate Governance frameworks in different countries. This chapter examines and evaluates governance frameworks of some of the select countries like Australia, Singapore, South Africa and United Kingdom.
INTRODUCTION

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

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

CORPORATE GOVERNANCE IN AUSTRALIA

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

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

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

Principles and Recommendations are non mandatory: These Principles and Recommendations recommend corporate governance practices for entities listed on the ASX that are likely to achieve good governance outcomes and meet the reasonable expectations of most investors in most situations. The Principles and Recommendations are not mandatory and do not seek to prescribe the corporate governance practices that a listed entity must adopt.

Principles and Recommendations are based on “if not, why not” approach: The “if not, why not” approach is fundamental to the operation of the Principles and Recommendations. Under the Principles and Recommendations, if the board of a listed entity considers that a recommendation is not appropriate to its particular circumstances, it is entitled not to adopt it. However, it must explain why it has not adopted the recommendation – the “if not, why not” approach.

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

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

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

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

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

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

There are 29 specific recommendations under these general principles.

**Principle 1: Lay solid foundations for management and oversight**

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

<table>
<thead>
<tr>
<th>Recommendations</th>
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<tbody>
<tr>
<td>Recommendation 1.1</td>
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<tr>
<td>Recommendation 1.2</td>
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and 
(b) provide security holders with all material information in its possession relevant to a decision on whether or not to elect or re-elect a director.

<table>
<thead>
<tr>
<th>Recommendation 1.3</th>
<th>A listed entity should have a written agreement with each director and senior executive setting out the terms of their appointment.</th>
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<tbody>
<tr>
<td>Recommendation 1.4</td>
<td>The company secretary of a listed entity should be accountable directly to the board, through the chair, on all matters to do with the proper functioning of the board.</td>
</tr>
</tbody>
</table>
| Recommendation 1.5 | A listed entity should:  
(a) have a diversity policy which includes requirements for the board or a relevant committee of the board to set measurable objectives for achieving gender diversity and to assess annually both the objectives and the entity’s progress in achieving them;  
(b) disclose that policy or a summary of it; and  
(c) disclose as at the end of each reporting period the measurable objectives for achieving gender diversity set by the board or a relevant committee of the board in accordance with the entity’s diversity policy and its progress towards achieving them, and either:  
- the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the entity has defined “senior executive” for these purposes); or  
- if the entity is a “relevant employer” under the Workplace Gender Equality Act, the entity’s most recent “Gender Equality Indicators”, as defined in and published under that Act. A relevant employer is a non-public sector employer with 100 or more employees in Australia for any 6 months or more of a reporting period. |
| Recommendation 1.6 | A listed entity should:  
(a) have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors; and  
(b) disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process. |
| Recommendation 1.7 | A listed entity should:  
(a) have and disclose a process for periodically evaluating the performance of its senior executives; and  
(b) disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process. |

**Principle 2: Structure the board to add value**
A listed entity should have a board of an appropriate size, composition, skills and commitment to enable it to discharge its duties effectively.

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

**Recommendations**

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Description</th>
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<tbody>
<tr>
<td>2.1</td>
<td>The board of a listed entity should: (a) have a nomination committee which: o has at least three members, a majority of whom are independent directors; and o is chaired by an independent director; o and disclose: • the charter of the committee; • the members of the committee; and • as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or (b) if it does not have a nomination committee, disclose that fact and the processes it employs to address board succession issues and to ensure that the board has the appropriate balance of skills, knowledge, experience, independence and diversity to enable it to discharge its duties and responsibilities effectively.</td>
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<tr>
<td>2.2</td>
<td>A listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.</td>
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<tr>
<td>2.3</td>
<td>A listed entity should disclose: (a) the names of the directors considered by the board to be independent directors; (b) if a director has an interest, position, association or relationship of the type described in below but the board is of the opinion that it does not compromise the independence of the director, the nature of the interest, position, association or relationship in question and an explanation of why the board is of that opinion; and (c) the length of service of each director.</td>
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<tr>
<td>2.4</td>
<td>A majority of the board of a listed entity should be independent directors.</td>
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<td>2.5</td>
<td>The chair of the board of a listed entity should be an independent director and, in particular, should not be the same person as the CEO of the entity.</td>
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<tr>
<td>2.6</td>
<td>A listed entity should have a program for inducting new directors and provide appropriate professional development opportunities for directors to develop and maintain the skills and knowledge needed to perform their role as directors effectively.</td>
</tr>
</tbody>
</table>
Factors relevant to assessing the independence of a director [for Recommendation 2.3(b)]

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

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

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

Principle 3: Act ethically and responsibly

A listed entity should act ethically and responsibly.

Recommendations

<table>
<thead>
<tr>
<th>Recommendation 3.1</th>
<th>A listed entity should:</th>
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<tbody>
<tr>
<td>(a)</td>
<td>have a code of conduct for its directors, senior executives and employees; and</td>
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<tr>
<td>(b)</td>
<td>disclose that code or a summary of it.</td>
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</table>

Principle 4: Safeguard integrity in corporate reporting

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

Recommendations

<table>
<thead>
<tr>
<th>Recommendation 4.1</th>
<th>The board of a listed entity should:</th>
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<tr>
<td>(a)</td>
<td>have an audit committee which:</td>
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<td>o has at least three members, all of whom are non-executive directors and a majority of whom are independent directors; and</td>
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<td>o is chaired by an independent director, who is not the chair of the board,</td>
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<td>and disclose:</td>
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<td></td>
<td>o the charter of the committee;</td>
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</table>
Recommendation 4.2
The board of a listed entity should, before it approves the entity’s financial statements for a financial period, receive from its CEO and CFO a declaration that, in their opinion, the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively.

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

Principle 5: Make timely and balanced disclosure
A listed entity should make timely and balanced disclosure of all matters concerning it that a reasonable person would expect to have a material effect on the price or value of its securities.

Recommendations

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

Principle 6: Respect the rights of security holders
A listed entity should respect the rights of its security holders by providing them with appropriate information and facilities to allow them to exercise those rights effectively.

Recommendations

Recommendation 6.1
A listed entity should provide information about itself and its governance to investors via its website.

Recommendation 6.2
A listed entity should design and implement an investor relations program to facilitate effective two-way communication with investors.

Recommendation 6.3
A listed entity should disclose the policies and processes it has in place to facilitate and encourage participation at meetings of security holders.
**Recommendation 6.4**  
A listed entity should give security holders the option to receive communications from, and send communications to, the entity and its security registry electronically.

**Principle 7: Recognise and manage risk**

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

**Recommendations**

<table>
<thead>
<tr>
<th>Recommendation 7.1</th>
<th>The board of a listed entity should:</th>
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<tr>
<td></td>
<td>(a) have a committee or committees to oversee risk, each of which:</td>
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<td>o has at least three members, a majority of whom are independent directors; and</td>
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<td>o is chaired by an independent director, and disclose:</td>
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<td>o the charter of the committee;</td>
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<td></td>
<td>o the members of the committee; and</td>
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<td></td>
<td>o as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or</td>
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<tr>
<td></td>
<td>(b) if it does not have a risk committee or committees that satisfy (a) above, disclose that fact and the processes it employs for overseeing the entity’s risk management framework.</td>
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<th>Recommendation 7.2</th>
<th>The board or a committee of the board should:</th>
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<td></td>
<td>(a) review the entity’s risk management framework at least annually to satisfy itself that it continues to be sound; and</td>
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<td></td>
<td>(b) disclose, in relation to each reporting period, whether such a review has taken place.</td>
</tr>
</tbody>
</table>

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<tr>
<th>Recommendation 7.3</th>
<th>A listed entity should disclose:</th>
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<td></td>
<td>(a) if it has an internal audit function, how the function is structured and what role it performs; or</td>
</tr>
<tr>
<td></td>
<td>(b) if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes.</td>
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</table>

| Recommendation 7.4 | A listed entity should disclose whether it has any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks. |

**Principle 8: Remunerate fairly and responsibly**

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

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

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

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

CORPORATE GOVERNANCE IN SINGAPORE

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

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

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

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


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

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

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

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

<table>
<thead>
<tr>
<th>No.</th>
<th>Heading</th>
<th>Principle</th>
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<tbody>
<tr>
<td>1.</td>
<td>The Board's Conduct of Affairs</td>
<td>Every company should be headed by an effective Board to lead and control the company. The Board is collectively responsible for the long-term success of the company. The Board works with Management to achieve this objective and Management remains accountable to the Board.</td>
</tr>
<tr>
<td>2.</td>
<td>Board Composition And Guidance</td>
<td>There should be a strong and independent element on the Board, which is able to exercise objective judgement on corporate affairs independently, in particular, from Management and 10% shareholders. No individual or small group of individuals should be allowed to dominate the Board's decision making.</td>
</tr>
<tr>
<td>3.</td>
<td>Chairman And Chief Executive Officer</td>
<td>There should be a clear division of responsibilities between the leadership of the Board and the executives responsible for managing the company's business. No one individual should represent a considerable concentration of power.</td>
</tr>
<tr>
<td>4.</td>
<td>Board Membership</td>
<td>There should be a formal and transparent process for the appointment and re-appointment of directors to the Board.</td>
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<tr>
<td>5.</td>
<td>Board Performance</td>
<td>There should be a formal annual assessment of the effectiveness of the Board as a whole and its Board Committees and the contribution by each director to the effectiveness of the Board.</td>
</tr>
<tr>
<td>6.</td>
<td>Access To Information</td>
<td>In order to fulfil their responsibilities, directors should be provided with complete, adequate and timely information prior to Board Meetings and on an on-going basis so as to enable them to make informed decisions to discharge their duties and responsibilities.</td>
</tr>
<tr>
<td>7.</td>
<td>Procedures For Developing Remuneration Policies</td>
<td>There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his own remuneration.</td>
</tr>
<tr>
<td>8.</td>
<td>Level and Mix of Remuneration</td>
<td>The level and structure of remuneration should be aligned with the long-term interest and risk policies of the company, and should be appropriate to attract, retain and motivate (a) the directors to provide good stewardship of the company, and (b) key management personnel to successfully manage the company. However, companies should avoid paying more than is necessary for this purpose.</td>
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</tbody>
</table>
9. **Disclosure on Remuneration**  
   Every company should provide clear disclosure of its remuneration policies, level and mix of remuneration, and the procedure for setting remuneration, in the company's Annual Report. It should provide disclosure in relation to its remuneration policies to enable investors to understand the link between remuneration paid to directors and key management personnel, and performance.

10. **Accountability**  
   The Board should present a balanced and understandable assessment of the company's performance, position and prospects.

11. **Risk Management and Internal Controls**  
   The Board is responsible for the governance of risk. The Board should ensure that Management maintains a sound system of risk management and internal controls to safeguard shareholders' interests and the company's assets, and should determine the nature and extent of the significant risks which the Board is willing to take in achieving its strategic objectives.

12. **Audit Committee**  
   The Board should establish an Audit Committee ("AC") with written terms of reference which clearly set out its authority and duties.

13. **Internal Audit**  
   The company should establish an effective internal audit function that is adequately resourced and independent of the activities it audits.

14. **Shareholder Rights**  
   Companies should treat all shareholders fairly and equitably, and should recognise, protect and facilitate the exercise of shareholders' rights, and continually review and update such governance arrangements.

15. **Communication with Shareholders**  
   Companies should actively engage their shareholders and put in place an investor relations policy to promote regular, effective and fair communication with shareholders.

16. **Conduct of Shareholder Meetings**  
   Companies should encourage greater shareholder participation at general meetings of shareholders, and allow shareholders the opportunity to communicate their views on various matters affecting the company.

**CORPORATE GOVERNANCE IN SOUTH AFRICA**

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

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

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

- **Leadership**: Good governance is essentially about effective leadership. Leaders should rise to the challenges of modern governance. Such leadership is characterised by the ethical values of responsibility, accountability, fairness and transparency and based on moral duties that find expression in the concept of Ubuntu. ‘Ubuntu’ is an idea from the South African Region which means literally “human-ness” and is often treated as humanity towards others. Responsible leaders direct company strategies and operations with a view to achieving sustainable economic, social and environmental performance.

- **Sustainability**: Sustainability is the primary moral and economic imperative of the 21st century. It is one of the most important sources of both opportunities and risks for businesses. Nature, society, and business are interconnected in complex ways that should be understood by decision-makers. Most importantly, current incremental changes towards sustainability are not sufficient – we need a fundamental shift in the way companies and directors act and organise themselves.

- **Corporate Citizenship**: The concept of corporate citizenship flows from the fact that the company is a person and should operate in a sustainable manner. Sustainability considerations are rooted in the South African Constitution which is the basic social contract that South Africans have entered into. The Constitution imposes responsibilities upon individuals and juristic persons for the realisation of the most fundamental rights.

The King III Report has also placed great emphasis on an integrated report, which will evaluate the company’s impact on the economic life of the community in which it operates, as well as many other matters.

**Code of Governance Principles**: The King III Report on Corporate Governance of South Africa has formulated Code of Governance Principles which applies to all entities regardless of the manner and form of incorporation or establishment and whether in the public, private sectors or non-profit sectors. All entities should apply the principles in the Code and consider the best practice recommendations in the Report. All entities should by way of explanation make a positive statement about how the principles have been applied or have not been applied. This level of disclosure will allow stakeholders to comment on and challenge the board on the quality of its governance. The manner of application will differ for each entity.

The Code applies to entities incorporated in and resident in South Africa. Foreign subsidiaries of local companies should apply the Code to the extent prescribed by the holding company and subject to entity-specific foreign legislation. The Code is effective in South Africa since March 2010.

Each principle is of equal importance and together forms a holistic approach to governance. Consequently, ‘substantial’ application of this Code and the Report does not achieve compliance.

<table>
<thead>
<tr>
<th>Governance element</th>
<th>Principles:</th>
</tr>
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</table>
| 1. Ethical leadership and corporate citizenship         | 1.1 The Board should provide effective leadership based on an ethical foundation.  
1.2 The Board should ensure that the company is seen to be a responsible corporate citizen.  
1.3 The Board should ensure that the company’s ethics are managed effectively. |
| 2. Boards and directors                                | 1.1. The Board should act as the focal point for and custodian of corporate governance.                                                                                                                      |
1.2. The Board should appreciate that strategy, risk, performance and sustainability are inseparable.

1.3. The Board should provide effective leadership based on an ethical foundation.

1.4. The Board should ensure that the company is as well as seen to be a responsible corporate citizen.

1.5. The Board should ensure that the company's ethics are managed effectively.

1.6. The Board should ensure that the company has an effective and independent audit committee.

1.7. The Board should be responsible for the governance of risk.

1.8. The Board should be responsible for information technology (IT) governance.

1.9. The Board should ensure that the company complies with applicable laws and considers adherence to non-binding rules, codes and standards.

1.10. The Board should ensure that there is an effective risk-based internal audit.

1.11. The Board should appreciate that stakeholders’ perceptions affect the company’s reputation.

1.12. The Board should ensure the integrity of the company’s integrated report.

1.13. The Board should report on the effectiveness of the company’s system of internal controls.

1.14. The Board and its directors should act in the best interests of the company.

1.15. The Board should consider business rescue proceedings or other turnaround mechanisms as soon as the company is financially distressed as defined in the Act.

1.16. The Board should elect a chairman of the board who is an independent non-executive director. The CEO of the company should not also fulfil the role of chairman of the board.

1.17. The Board should appoint the chief executive officer and establish a framework for the delegation of authority.

1.18. The Board should comprise a balance of power, with a majority of non-executive directors. The majority of non-executive directors should be independent.

1.19. Directors should be appointed through a formal process.

1.20. The induction of and ongoing training and development of directors should be conducted through formal processes.

1.21. The Board should be assisted by a competent, suitably qualified and experienced company secretary.

1.22. The evaluation of the board, its committees and the individual directors should be performed every year.

1.23. The Board should delegate certain functions to well-structured
committees but without abdicating its own responsibilities.

1.24. A governance framework should be agreed between the group and its subsidiary boards.

1.25. Companies should remunerate directors and executives fairly and responsibly.

1.26. Companies should disclose the remuneration of each individual director and prescribed officer.

1.27. Shareholders should approve the company’s remuneration policy.

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<tr>
<th>3. Audit committees</th>
<th>3.1 The Board should ensure that the company has an effective and independent audit committee.</th>
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<td></td>
<td>3.2 Audit committee members should be suitably skilled and experienced independent non-executive directors.</td>
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<td>3.3 The audit committee should be chaired by an independent non-executive director.</td>
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<td>3.4 The audit committee should oversee integrated reporting.</td>
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<td>3.5 The audit committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities.</td>
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<td>3.6 The audit committee should satisfy itself of the expertise, resources and experience of the company’s finance function.</td>
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<td>3.7 The audit committee should be responsible for overseeing of internal audit.</td>
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<td>3.8 The audit committee should be an integral component of the risk management process.</td>
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<td>3.9 The audit committee should be an integral component of the risk management process.</td>
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<td></td>
<td>3.10 The audit committee should report to the board and shareholders on how it has discharged its duties.</td>
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<tr>
<th>4. The governance of risk</th>
<th>4.1 The board should be responsible for the governance of risk.</th>
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<td>4.2 The board should determine the levels of risk tolerance.</td>
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<td>4.3 The risk committee or audit committee should assist the board in carrying out its risk responsibilities.</td>
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<td>4.4 The board should delegate to management the responsibility to design, implement and monitor the risk management plan.</td>
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<td>4.5 The board should ensure that risk assessments are performed on a continual basis.</td>
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<td>4.6 The board should ensure that frameworks and methodologies are implemented to increase the probability of anticipating unpredictable risks.</td>
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<td>4.7 The board should ensure that management considers and implements appropriate risk responses.</td>
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<td>4.8 The board should ensure continual risk monitoring by management.</td>
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<td></td>
<td>4.9 The board should receive assurance regarding the effectiveness of the risk management process.</td>
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<td>4.10 The board should ensure that there are processes in place enabling</td>
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<td>Legislative Framework of Corporate Governance</td>
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<td></td>
<td>- An International Perspective</td>
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<tr>
<td>complete, timely, relevant, accurate and accessible risk disclosure to stakeholders.</td>
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</tbody>
</table>
| **5. The governance of information technology** | **5.1** The board should be responsible for information technology (IT) governance.  
**5.2** IT should be aligned with the performance and sustainability objectives of the company.  
**5.3** The board should delegate to management the responsibility for the implementation of an IT governance framework.  
**5.4** The board should monitor and evaluate significant IT investments and expenditure.  
**5.5** IT should form an integral part of the company’s risk management.  
**5.6** The board should ensure that information assets are managed effectively.  
**5.7** A risk committee and audit committee should assist the board in carrying out its IT responsibilities. |
| **6. Compliance with laws, rules, codes and standards** | **6.1** The board should ensure that the company complies with applicable laws and considers adherence to nonbinding rules, codes and standards.  
**6.2** The board and each individual director should have a working understanding of the effect of the applicable laws, rules, codes and standards on the company and its business.  
**6.3** Compliance risk should form an integral part of the company’s risk management process.  
**6.4** The board should delegate to management the implementation of an effective compliance framework and processes. |
| **7. Internal audit** | **7.1** The board should ensure that there is an effective risk based internal audit.  
**7.2** Internal audit should follow a risk based approach to its plan.  
**7.3** Internal audit should provide a written assessment of the effectiveness of the company’s system of internal controls and risk management.  
**7.4** The audit committee should be responsible for overseeing internal audit.  
**7.5** Internal audit should be strategically positioned to achieve its objectives. |
| **8. Governing stakeholder relationships** | **1.1** The board should appreciate that stakeholders’ perceptions affect a company’s reputation.  
**1.2** The board should delegate to management to proactively deal with stakeholder relationships.  
**1.3** The board should strive to achieve the appropriate balance between its various stakeholder groupings, in the best interests of the company.  
**1.4** Companies should ensure the equitable treatment of shareholders  
**1.5** Transparent and effective communication with stakeholders is essential for building and maintaining their trust and confidence.  
**1.6** The board should ensure that disputes are resolved as effectively, efficiently and expeditiously as possible. |
| **9. Integrated reporting** | **9.1** The board should ensure the integrity of the company’s integrated report. |
9.2 Sustainability reporting and disclosure should be integrated with the company's financial reporting.

9.3 Sustainability reporting and disclosure should be independently assured.

CORPORATE GOVERNANCE IN UNITED KINGDOM

The UK has some of the highest standards of corporate governance in the world, which makes the UK market attractive to new investment.

The development of corporate governance in the UK has its roots in a series of corporate collapses and scandals in the late 1980s and early 1990s. The first version of the UK Corporate Governance Code (the Code) was produced in 1992 by the Cadbury Committee. It has been instrumental in spreading best boardroom practice throughout the listed sector since it was first issued. It operates on the principle of 'comply or explain'. It sets out good practice covering issues such as board composition and effectiveness, the role of board committees, risk management, remuneration and relations with shareholders.

A requirement was added to the Listing Rules of the London Stock Exchange that companies should report whether they had followed the recommendations or, if not, explain why they had not done so (this is known as 'comply or explain'). Listed companies are required under the Financial Conduct Authority Listing Rules either to comply with the provisions of the Code or explain to investors in their next annual report why they have not done so. If shareholders are not content they should engage with the company. If this is unsatisfactory, they can use their rights, including the power to appoint and remove directors, to hold the company to account.

The recommendations in the Cadbury Report have been added to at regular intervals since 1992. In 1995 a separate report set out recommendations on the remuneration of directors, and in 1998 the two reports were brought together in a single code (known initially as the Combined Code and now as the UK Corporate Governance Code). In 1999 separate guidance was issued to directors on how to develop risk management and internal control systems, which has subsequently been updated.

In 2003 the Code was updated to incorporate recommendations from reports on the role of non-executive directors and the role of the audit committee. At this time the UK Government decided that the Financial Reporting Council (FRC), the independent regulator responsible for corporate governance and reporting, was to take responsibility for publishing and maintaining the UK Approach to Corporate Governance (October 2010) Code. The FRC has updated the Code at again in 2010 to reflect lessons learnt from the problems in the UK's financial services sector.

Throughout all of these changes, the 'comply or explain' approach first set out in the Cadbury Report has been retained. There are a number of advantages to the 'comply or explain' approach. Its inherent flexibility means that it is possible to set more demanding standards than can be done through hard rules. Experience has shown that the vast majority of companies attain these standards. In addition, requiring companies to report to shareholders rather than regulators means that the decision on whether a company's governance is adequate is taken by those in whose interest the board is meant to act.

In 2010 the 'comply or explain' approach was reinforced by the UK Stewardship Code, under which institutional investors report on their policies for monitoring and engaging with the companies in which they invest. This Code sets standards for investors for monitoring and engaging with the companies they own and aims to improve the quality of dialogue between investors and companies to help improve long-term risk-adjusted returns to shareholders. The Stewardship Code sets out a number of areas of good practice to which the FRC believes institutional investors should aspire and also operates on a 'comply or explain' basis.
The FCA requires UK authorised asset managers to report on whether or not they apply the Code. In a similar way to the UK Corporate Governance Code, the UK Stewardship Code aims to make investors more accountable to their clients and beneficiaries, as well as helping companies.

The Financial Reporting Council (the “FRC”) has published a revised version of the UK Corporate Governance Code (the “Code”) containing guidance on risk management and internal controls, remuneration policies and engagement with shareholders in September 2014. The new Code was applicable to accounting periods beginning on or after 1st October 2014 and to all companies with a Premium listing of equity shares regardless of whether they are incorporated in the UK or elsewhere.

Both Codes are normally updated every two years to ensure they stay relevant. Any changes are subject to extensive consultation and dialogue with the market. The most recent UK Corporate Governance Code was published in September 2014 and the most recent UK Stewardship Code was published in September 2012.

**UK Corporate Governance Code, 2014:** Whilst primarily aimed at companies with a Premium Listing of shares in the UK, who are required under the Listing Rules to “comply or explain” in their annual report and accounts, the broad principles of the Code may be of interest to other companies who may consider that it would be beneficial to adopt certain of the provisions. The FRC has emphasised the importance of the board in establishing the correct “tone from the top” and that the board should lead by example to prevent misconduct, unethical practices and support the delivery of long-term success. The FRC was also keen to establish the appropriate relationship between the board’s risk assessment and management responsibilities.

The FRC has proposed that companies make two separate statements in its annual report:

- one stating whether they consider it appropriate to adopt the going concern basis of accounting in preparing the annual and half-yearly financial statements and
- another statement relating to a broad assessment of the company’s viability over a specified period, which is expected to be significantly longer than twelve months.

The directors should also confirm in the annual report that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten the business model, future performance, solvency or liquidity. The directors should describe those risks and explain how they are being managed or mitigated.

The main principles of the Code are given below:

**Section A: Leadership**

| A.1: The Role of the Board | Every company should be headed by an effective board which is collectively responsible for the long-term success of the company. |
| A.2: Division of Responsibilities | There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company’s business. No one individual should have unfettered powers of decision. |
| A.3: The Chairman | The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role. |
| A.4: Non-Executive Directors | As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. |
Section B: Effectiveness

| B.1: The Composition of the Board | The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively. |
| B.2: Appointments to the Board | There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. |
| B.3: Commitment | All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively. |
| B.4: Development | All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge. |
| B.5: Information and Support | The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. |
| B.6: Evaluation | The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. |
| B.7: Re-election | All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. |

Section C: Accountability

| C.1: Financial and Business Reporting | The board should present a fair, balanced and understandable assessment of the company’s position and prospects. |
| C.2: Risk Management and Internal Control | The board should maintain sound risk management and internal control systems. |
| C.3: Audit Committee and Auditors | The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting, risk management and internal control principles and for maintaining an appropriate relationship with the company’s auditors. |

Section D: Remuneration

| D.1: The Level and Components of Remuneration | Executive directors’ remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied. |
| D.2: Procedure | There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration. |

Section E: Relations with shareholders

| E.1: Dialogue with shareholders | There should be a dialogue with shareholders based on the mutual
Shareholders understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.

E.2: Constructive Use of General Meetings

The board should use general meetings to communicate with investors and to encourage their participation.

CORPORATE GOVERNANCE CODES – GLOBALLY

The list of certain latest corporate governance codes or principles of corporate governance followed by various countries globally are given below. The full texts of these codes, students may refer http://www.ecgi.org/codes/all_codes.php

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<td>Code of Corporate Governance of the Republic of Armenia 30 December 2010</td>
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<td>Australia</td>
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<td>France</td>
<td>AFEP-MEDEF Corporate governance code of listed corporations (Revised June 2013) June 2013</td>
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<td>Corporate Governance Code for Commercial Banks 23 September 2009</td>
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<td>Germany</td>
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**CORPORATE GOVERNANCE AT UK, SINGAPORE, AUSTRALIA, SOUTH AFRICA AND INDIA – A COMPARATIVE TABLE**

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<td>Australia – Corporate Governance Principles and Recommendations, 2014</td>
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<td>South Africa – King III Report</td>
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<td></td>
<td>India – SEBI (Listing Obligations &amp; Disclosure Requirements) Regulations, 2015</td>
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<td><strong>2. APPLICABILITY</strong></td>
<td>UK – Companies with Premium Listing of Equity Shares at London Stock Exchange whether incorporated in UK or not.</td>
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<td></td>
<td>Singapore – Listed Companies</td>
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<td></td>
<td>South Africa – All entities</td>
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<tr>
<td></td>
<td>Australia – All listed companies</td>
</tr>
<tr>
<td></td>
<td>India – Listed Companies</td>
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<tr>
<td><strong>3. THE BOARD</strong></td>
<td>UK – The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established set out in writing and agreed by the board. (A.2.1)</td>
</tr>
<tr>
<td>Separation of role of Chairman and Chief Executive</td>
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<tr>
<td>Country</td>
<td>Policy</td>
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<tr>
<td>Singapore</td>
<td>The chairman and chief executive officer (&quot;CEO&quot;) should in principle be separate persons, to ensure an appropriate balance of power, increased accountability and greater capacity of the Board for independent decision making. The division of responsibilities between the Chairman and CEO should be clearly established, set out in writing and agreed by the Board. In addition, the Board should disclose the relationship between the Chairman and CEO if they are immediate family. (Guideline 3.1)</td>
</tr>
<tr>
<td>South Africa</td>
<td>The Board should be led by an independent non-executive Chairman who should not be the CEO of the company. (Principle 1.18)</td>
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<tr>
<td>Australia</td>
<td>The roles of the Chair and Chief Executive Officer should not be exercised by the same individuals. (Recommendation 2.3)</td>
</tr>
<tr>
<td>India</td>
<td>Separation of roles not mandatory</td>
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<tr>
<td>UK</td>
<td>The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.</td>
</tr>
<tr>
<td>Singapore</td>
<td>• There should be a strong and independent element on the Board, which is able to exercise objective judgement on corporate affairs independently, in particular, from Management. No individual or small group of individuals should be allowed to dominate the Board’s decision making. (Principle 2)</td>
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<td></td>
<td>• An “independent” director is one who has no relationship with the company, its related companies or its officers that could interfere, or be reasonably perceived to interfere, with the exercise of the director’s independent business judgement with a view to the best interests of the company. (Guideline 2.1)</td>
</tr>
<tr>
<td>South Africa</td>
<td>The Board should comprise a balance of executive and non-executive directors, with a majority of non-executive directors</td>
</tr>
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<td></td>
<td>• A balance of executive and non-executive directors, with a majority of non-executive directors should exist in the Board of Directors.</td>
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<td></td>
<td>The principal of independence should also be considered.</td>
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<td>A minimum of two executive directors should be appointed. This should include the CEO and the Chief Financial Officer/ Director.</td>
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<tr>
<td>• Rotation of non-executive directors should be practised by public companies.</td>
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<tr>
<td>• The Board should be entitled to remove the CEO as an executive director, without shareholder approval. This requires a suitable amendment of the Memorandum of Incorporation (currently the Articles of Association). (Principle 1.17)</td>
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</table>

**Australia**

**A majority of the Board should be independent directors**

An independent director is a non-executive director who is not a member of management and who is free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the independent exercise of their judgement. (Recommendation 2.4)

**India**

Atleast 1/3rd of the Board should be independent if the Chairman is a non-executive director and atleast 50% of the Board should be independent director if the Chairman is executive director.

**Senior Independent Director and his role**

**UK**

The board should appoint one of the independent non-executive directors to be the senior independent director. The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate. (A 4.1 of UK Code)

**Singapore**

Companies may appoint an independent non-executive director to be the lead independent director where the Chairman and the CEO is the same person, where the Chairman and the CEO are related by close family ties, or where the Chairman and the CEO are both part of the executive management team. The lead independent director (if appointed) should be available to shareholders where they have concerns which contact through the normal channels of the Chairman, CEO or Finance Director has failed to resolve or for which such contact is inappropriate. (Guideline 3.3)
South Africa
The appointment of a lead independent non-executive director assists a company in that:

- It enables the Chairman to hand over control of the meeting, when he has a conflict of interest.
- The role of the LID is to assist the Chairman.
- When the question of the Chairman's performance appraisal and the question of the term of the office of the Chairman are considered, the LID shall be the Chairman of the meeting. (Chapter 1 Note 2)

Australia
The appointment of lead independent Director is recommendatory.
Where the chair is not an independent director, it may be beneficial to consider the appointment of the lead independent director. (Commentary to Recommendation 2.5)

India
Appointment of Senior/lead independent Director is not mandatory.

Prescribed Board Committees

UK
Audit Committee (C 3.1), Nomination Committee (B 2.1) and Remuneration Committees (D.1) (Supporting Principle)

Singapore
Audit Committee, Nominating Committee and Remuneration Committee. (Guideline 4.1, 9.1, 11.8)

South Africa
Audit Committee (Principle 3.10)
Risk Committee (Principle 4.7)
Remuneration and Nomination Committee. (Principle 1.24)

Australia
Nomination Committee (Recommendation 2.1)
Audit Committee (Recommendation 4.1)
Remuneration Committee (Recommendation 8.1)

India
Audit Committee, Nomination & Remuneration Committee, Stakeholders Relationship and CSR Committee

Board Meeting

UK
The board should meet sufficiently regularly to discharge its duties.
effectively. (A.1.1 of UK Code)

**Singapore**

The board should meet regularly and as warranted by particular circumstances, as deemed appropriate by the board members. Companies are encouraged to amend their Articles of Association to provide for telephonic and video conference meetings. The number of board and board committee meetings held in the year, as well as the attendance of every board member at these meetings, should be disclosed in the company's annual report. (Guideline 1.4)

**South Africa**

The Board should meet at least once per annum to consider the Board appraisal results. (Principle 1.23)

**India**

The Board shall meet at least four times a year, with a maximum time gap of four months between any two meetings.

### 2. APPOINTMENT OF BOARD MEMBERS

<table>
<thead>
<tr>
<th>Board appointments</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. (B 2 main principle of UK Code)</td>
</tr>
</tbody>
</table>

**Singapore**

Nominating Committee("NC") recommends to the Board on all board appointments. (Guideline 4.1)

**South Africa**

**Directors should be appointed through a formal process**

- Shareholders are responsible for the composition of the Board.
- The Board as a whole would normally appoint directors, assisted by recommendations from the Nominations Committee.
- The background of all potential directors should be verified before an invitation is extended to join the Board. (Principle 1.20)

**Australia**

Nomination Committee is responsible for appointment and re-election of directors. (Commentary to Recommendation 2.1)
<table>
<thead>
<tr>
<th>Inspection</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>The terms and conditions of appointment of non-executive directors should be made available for inspection. (B 3.2 of UK Code)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is no specific provision</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is no specific provision</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is no specific provision</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Nomination &amp; Remuneration Committee shall indentify persons who are qualified to become directors.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Nomination Committee</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>There should be a nomination committee which should lead the process for board appointments and make recommendations to the board. A majority of members of the nomination committee should be independent non-executive directors. (B 2.1 of UK Code)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies should establish a Nominating Committee (&quot;NC&quot;) to make recommendations to the Board on all board appointments. The NC should comprise at least three directors, a majority of whom, including the Chairman, should be independent. (Guideline 4.1)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>There should be a nomination committee. (Principle 1.24)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>The board should establish a nomination committee. (Recommendation 2.1)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>The company shall set up a nomination and remuneration committee which shall comprise at least 3 independent directors, all of whom shall be non-executive directors and at least half shall be independent.</td>
</tr>
</tbody>
</table>
### 3. INFORMATION, INDUCTION, TRAINING AND PROFESSIONAL DEVELOPMENT

<table>
<thead>
<tr>
<th>Information to the Board</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. (B.5 of UK Code)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>In order to fulfil their responsibilities, Board members should be provided with complete, adequate and timely information prior to board meetings and on an ongoing basis. (Principle 6)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>A process should be agreed to provide directors with access to company information and records. (Principle 1.6)</td>
</tr>
<tr>
<td>The Board may seek guidance of Company Secretary on Board Responsibilities. (Principle 1.22)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board should be provided with the information it needs to discharge its responsibilities effectively.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>The minimum information to be made available to the Board.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Induction</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board. As part of this, directors should avail themselves of opportunities to meet major shareholders. (B 4.1 of UK Code)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Every director should receive appropriate training (including his or her duties as a director and how to discharge those duties) when he is first appointment to the Board. This should include an orientation program to ensure that incoming directors are familiar with the company’s business and governance practices. (Guideline 1.6)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Training and development of directors should be conducted through formal processes</td>
</tr>
<tr>
<td>• A formal orientation programme is required.</td>
</tr>
<tr>
<td>• The orientation programme may include an introductory programme.</td>
</tr>
<tr>
<td>• New directors should receive development and</td>
</tr>
<tr>
<td>Professional Development</td>
</tr>
<tr>
<td>--------------------------</td>
</tr>
<tr>
<td><strong>Australia</strong></td>
</tr>
<tr>
<td><strong>India</strong></td>
</tr>
</tbody>
</table>

**UK**

All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge. (B.4 Supporting Principle of UK Code)

**Singapore**

It is important that directors should receive further relevant training, particularly on relevant new laws, regulations and changing commercial risks, from time to time. (Guideline 1.6)

**South Africa**

Performance appraisals should be used as the basis for identifying future training needs. (Principle 1.23)

**Australia**

Continuing Education Programme is recommended. (Commentary to Recommendation 1.1)

**India**

A company may train its Board members in the business model of the company as well as risk profile of the business parameters of the company, their responsibilities as directors and the best ways to discharge them.

### 4. PERFORMANCE EVALUATION

**UK**

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. (B.6 of UK Code)

**Singapore**

There should be a formal assessment of the effectiveness of the Board as a whole and the contributiveness of the Board as a
whole and the contribution by each director to the effectiveness of the Board. (Principle 5)

Every Board should implement a process to be carried out by the NC for assessing the effectiveness of the Board as a whole and for assessing the contribution by each individual director to the effectiveness of the Board. This assessment process should be disclosed in the annual report. (Guideline 5.1)

**South Africa**

**The performance of the Board, its Committees and individual directors should be evaluated annually**

- Regular and timely appraisals of the Board should be conducted.
- A prerequisite for evaluation is the regular evaluation by the Board of its own function.
- The evaluation result should be reviewed by the Nomination Committee, or by the Board.
- Performance appraisals should be used as the basis for identifying future training needs.
- The Board should meet at least once per annum to consider the Board appraisal results.
- Evaluations should also take place in respect of:
  - Board Committees
  - Chairmen of Board Committees
  - Individual directors
  - Directors should be subject to evaluation before the Board proposes, and shareholders agree, to their reappointment.
  - An independent non-executive director should be appointed to lead the process of the assessment of the performance of the Chairman of the Board.
  - The performance of the CEO and executive directors should be undertaken at periods of at least once every year. This evaluation will concentrate on the CEO’s performance, as a director and as the Chief Executive Officer. Their reports should be considered by the Remuneration Committee and then by the Board. (Principle 1.23)

**Australia**

Companies to disclose the process for evaluating the performance of the board, its committees and individual directors. (Recommendation 2.5)
### 5. TERMS OF OFFICE AND RE-ELECTION

#### Election and re-election

<table>
<thead>
<tr>
<th>Country</th>
<th>Details</th>
</tr>
</thead>
</table>
| **UK**  | All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. (B7)  
All directors of FTSE 350 companies should be subject to annual election by shareholders. All other directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. (B7.1 of UK Code) |

<table>
<thead>
<tr>
<th>Country</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Singapore</strong></td>
<td>All directors should be required to submit themselves for re-</td>
</tr>
</tbody>
</table>

**India**  
The performance evaluation of non-executive directors could be done by a peer group comprising the entire Board of Directors, excluding the director being evaluated; and Peer Group evaluation could be the mechanism to determine whether to extend/continue the terms of appointment of the non-executive directors.

**UK**  
The non-executive directors, led by the senior independent director should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.  
(B.6.3 of UK Code)

**Singapore**  
No specific provision seems to exist for performance evaluation of Chairman.

**South Africa**  
The performance of the CEO and executive directors should be undertaken at periods of at least once every year. This evaluation will concentrate on the CEO’s performance, as a director and as the Chief Executive Officer. Their reports should be considered by the Remuneration Committee and then by the Board. (Principle 1.23)

**Australia**  
There is no specific provision relating to performance evaluation of the Chairman as such.

**India**  
No provision.
nomination and re-election at regular intervals and at least every three years. (Guideline 4.2)

**South Africa**
Rotation of non-executive directors should be practised by public companies. This will ensure that one third of the non-executive directors retire each year, by rotation. (Principle 1.17)

**Australia**
Provisions relating to terms of office and re-election have been specified. (Recommendation 2.4)

**India**
No such provision.

<table>
<thead>
<tr>
<th>Non-executive Directors – Re-election beyond 6 years</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>A non-executive director may serve longer than 9 years subject to annual re-election. [B 7.1 of UK Code]</td>
<td></td>
</tr>
</tbody>
</table>

**Singapore**
No specific provision is provided.

**South Africa**
Rotation of non-executive directors should be practised by public companies. This will ensure that one third of the non-executive directors retire each year, by rotation. (Principle 1.17)

**Australia**
No specific provision is provided.

**India**
No specific provision.

<table>
<thead>
<tr>
<th>Non-executive Directors Re-election beyond 9 years</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>A non-executive director may serve longer than 9 years subject to annual re-election. [B 7.1 of UK Code]</td>
<td></td>
</tr>
</tbody>
</table>

**Singapore**
No specific provision is provided.

**South Africa**
Rotation of non-executive directors should be practised by public companies. This will ensure that one third of the non-executive directors retire each year, by rotation. (Principle 1.17)

**Australia**
No specific provision is provided.
## 6. REMUNERATION

<table>
<thead>
<tr>
<th>Country</th>
<th>Remuneration to be linked to Corporate and individual performance</th>
<th>UK</th>
<th>Singapore</th>
<th>South Africa</th>
<th>Australia</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>Maximum tenure will be as per Company Act 2013 Sec 149(10)</td>
<td>A significant proportion of executive director’s remuneration should be structured so as to link rewards to corporate and individual performance.</td>
<td>The performance-related elements of remuneration should be designed to align interests of executive directors with those of shareholders and link rewards to corporate and individual performance. There should be appropriate and meaningful measures for the purpose of assessing executive directors’ performance. (Guideline 8.1)</td>
<td>Remuneration policies should be aligned with the company’s strategy. (Principle 1.26)</td>
<td>There are guidelines for performance related remuneration appropriate to company’s circumstances and goals. (Principle 8, commentary to recommendation 8.3)</td>
<td>No provision.</td>
</tr>
<tr>
<td>UK</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>South Africa</td>
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<td></td>
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<tr>
<td>Australia</td>
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<td></td>
</tr>
</tbody>
</table>

### Remuneration Committee

<table>
<thead>
<tr>
<th>Country</th>
<th>UK</th>
<th>Singapore</th>
<th>South Africa</th>
<th>Australia</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>The board should establish a remuneration committee of at least three, or in the case of smaller companies - two, independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman. (D 2.1 of UK Code)</td>
<td>The Board should set up a Remuneration Committee (“RC”) comprising entirely of non-executive directors, the majority of whom, including the Chairman, should be independent. This is to minimise the risk of any potential conflict of interest. (Guideline 7.1)</td>
<td>The Remuneration Committee should consist of non-executive directors.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Remuneration Policy</td>
<td>Australia</td>
<td>The Board should establish remuneration committee. (Recommendation 8.1)</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>The Board shall constitute Nomination and Remuneration Committee.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Remuneration Policy</td>
<td>UK</td>
<td>Remuneration Policy is required. (D2 of UK Code)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Singapore</td>
<td>Each company should provide clear disclosure of its remuneration policy, level and mix of remuneration, and the procedure for setting remuneration in the company’s annual report. (Principle 9)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>South Africa</td>
<td>Shareholders should approve the company’s remuneration policy</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Australia</td>
<td>The company should design its remuneration policy in such a way that it:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Motivates senior executives to pursue the long-term growth and success of the company.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Demonstrates a clear relationship between senior executives’ performance and remuneration. (Commentary to Recommendation 8.1)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Performance linked remuneration</td>
<td>UK</td>
<td>The code prescribed methods for performance related remuneration should be followed. (D.1.1 of UK Code)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Singapore</td>
<td>The level of remuneration should be appropriate to attract, retain and motivate the directors needed to run the company successfully</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
but companies should avoid paying more than is necessary for this purpose. A significant proportion of executive directors’ remuneration should be structured so as to link rewards to corporate and individual performance. (Principle 8)

**South Africa**

Annual bonuses should be clearly related to performance objectives. (Principle 1.27)

**Australia**

Companies should ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to performance is clear. (Principle 8)

Incentive schemes should be designed around appropriate performance benchmarks that measure relative performance and provide rewards for materially improved company performance. (Guidelines to Principle 8)

**India**

Details of fixed component and performance linked incentive, along with the performance criteria shall be made in the section on the corporate governance of the Annual Report.

<table>
<thead>
<tr>
<th>Remuneration to Executive Directors</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>UK</strong></td>
<td></td>
</tr>
<tr>
<td>There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her on remuneration.</td>
<td></td>
</tr>
<tr>
<td>The remuneration committee should consult the chairman and/or chief executive about their proposals relating to the remuneration of other executive directors.</td>
<td></td>
</tr>
<tr>
<td>(D.2 of UK Code)</td>
<td></td>
</tr>
</tbody>
</table>

**Singapore**

The performance-related elements of remuneration should be designed to align interests of executive directors with those of shareholders and link rewards to corporate and individual performance. There should be appropriate and meaningful measures for the purpose of assessing executive directors’ performance. (Guideline 8.1)

**South Africa**

**Companies should remunerate fairly and responsibly**

- Remuneration policies should be aligned with the company’s strategy.
- Every endeavour should be made to promote a culture
<table>
<thead>
<tr>
<th>Remuneration to non-executive directors</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Australia</strong></td>
<td></td>
</tr>
<tr>
<td>Executive directors’ and senior executives’ remuneration packages should involve a balance between fixed and incentive pay, reflecting short and long-term performance objectives appropriate to the company’s circumstances and goals. (Principle 8, commentary to recommendation 8.2)</td>
<td></td>
</tr>
<tr>
<td><strong>India</strong></td>
<td></td>
</tr>
<tr>
<td>The Board shall set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company’s policy on specific remuneration package for executive directors including pension rights and any compensation payment.</td>
<td></td>
</tr>
<tr>
<td><strong>Singapore</strong></td>
<td></td>
</tr>
<tr>
<td>The remuneration of non-executive directors should be appropriate to the level of contribution, taking into account factors such as effort and time spent, and responsibilities of the directors. Non-executive directors should not be over-compensated to the extent that their independence may be compromised. (Guideline 8.2)</td>
<td></td>
</tr>
<tr>
<td><strong>South Africa</strong></td>
<td></td>
</tr>
<tr>
<td>Shareholders should approve non-executive fees in advance. (Principle 1.27)</td>
<td></td>
</tr>
<tr>
<td><strong>Australia</strong></td>
<td></td>
</tr>
<tr>
<td>Companies may find it useful to consider the following when considering non-executive director remuneration:</td>
<td></td>
</tr>
<tr>
<td>1) Non-executive directors should normally be remunerated by way of fees, in the form of cash, noncash benefits, superannuation contributions or salary sacrifice into equity; they should not normally participate in schemes designed for the remuneration of executives.</td>
<td></td>
</tr>
<tr>
<td>2) Non-executive directors should not receive options or bonus payments.</td>
<td></td>
</tr>
<tr>
<td>3) Non-executive directors should not be provided with retirement benefits other than superannuation. (Guidelines to Principle 8)</td>
<td></td>
</tr>
</tbody>
</table>

(Principle 1.26)
### India
There is no specific procedure for determining the remuneration to non-executive directors. However, the company shall publish the criteria for determination of remuneration to non-executive directors.

### Share-options to non-executive directors

**UK**
Remuneration for non-executive directors should not include share options. If, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the non-executive director leaves the board. Holding of share options could be relevant to the determination of a non-executive director’s independence.

(D 1.3 of UK Code)

**Singapore**
No specific provisions relating to stock options to Non-executive Directors.

**South Africa**
Non-executive directors should not receive share options.

(Principle 1.27)

**Australia**
Non-executive directors should not be given options.

(Guidelines to Principle 8)

**India**
Stock option details, if any and whether issued at a discount as well as the period over which accrued and over which exercisable shall be made in the section on the corporate governance of the Annual Report.

### 7. FINANCIAL REPORTING

**Responsibility of the Board in financial Reporting**

**UK**
The board should present a balanced and understandable assessment of the company’s position and prospects. The board’s responsibility to present a balanced and understandable assessment extends to interim and other price-sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements.

(C.1 of UK Code)

**Singapore**
The duties of audit Committee includes reviewing the significant
financial reporting issues and judgements so as to ensure the integrity of the financial statements of the company and any formal announcements relating to the company’s financial performance. (Guideline 11.4(b))

**South Africa**

The Board should ensure the integrity of financial reporting (Principle 1.11)

**Australia**

Companies should have a structure to independently verify and safeguard the integrity of their financial reporting. (Principle 4)

Ultimate responsibility for the integrity of a company’s financial reporting rests with the full board whether or not a separate audit committee exists. (Recommendation to Principle 4)

**India**

The Audit Committee shall perform an 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.

<table>
<thead>
<tr>
<th>Internal control</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The board should maintain a sound system of internal control and report to shareholders that they have done so. (C.2 of UK Code 2008)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Board should ensure that the Management maintains sound system internal controls to safeguard the shareholders’ investments and the assets. (Principle 12)</td>
</tr>
</tbody>
</table>

The AC should ensure that a review of the effectiveness of the company’s internal controls is conducted at least annually. Such review can be carried out by the internal and/or public accountants, provided that where the public accountant is also the external auditor of the company, the AC should satisfy itself that the independence of the public accountant is not compromised by any other material relationship with the company. (Guidelines : 12.1)

<table>
<thead>
<tr>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal audit should provide the Board with a written assessment of the effectiveness of the company’s system of internal control, performance and risk management. (Principle 5.2)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies should establish a sound system of risk oversight and</td>
</tr>
</tbody>
</table>
management and internal control. (Principle 7)

**India**

The management discussion and analysis report should include discussion on internal control systems and their adequacy within the limits set by the company’s competitive position. [Clause 49(IV)(F)]

The Audit Committee shall review with the management performance of statutory and internal auditors, adequacy of the internal control systems.

---

### Audit Committee

**UK**

All listed companies must have an Audit Committee.

(C.3 of UK Code)

**Singapore**

The Board should establish an Audit Committee (“AC”) with written terms of reference which clearly set out its authority and duties. (Principle 11)

**South Africa**

The company should have an effective Audit Committee. (Principle 3.1)

**Australia**

The board should establish an audit committee. (Principle 4, Recommendation 4.1)

**India**

All listed companies must have an Audit Committee.

---

### Audit Committee Composition

**UK**

The board should establish an audit committee of at least three, or in the case of smaller companies, two independent non-executive directors. (C.3 of UK Code)

**Singapore**

The AC should comprise at least three directors, all non-executive, the majority of whom, including the Chairman, should be independent. (Guideline 11.1)

**South Africa**

Audit Committee members should:

- Be independent non-executive directors;
- Have a level of financial literacy;
- Not include the Chairman of the Board. (Principle 3.1)
<table>
<thead>
<tr>
<th><strong>Australia</strong></th>
<th><strong>India</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>The Audit Committee should be structured so that it:</td>
<td>The Audit Committee shall have minimum three directors as members. Two-third of the members of Audit Committee shall be independent directors.</td>
</tr>
<tr>
<td>• Consists only of non-executive directors</td>
<td></td>
</tr>
<tr>
<td>• Consists of a majority of independent directors</td>
<td></td>
</tr>
<tr>
<td>• Is chaired by an independent chair, who is not chair of the board</td>
<td></td>
</tr>
<tr>
<td>• Has at least three members. (Principle 4, Recommendation 4.2)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Financial Expert in the Audit Committee</strong></th>
<th><strong>UK</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The Board should satisfy itself that at least one member of the Audit Committee has recent and relevant financial experience.</td>
</tr>
<tr>
<td></td>
<td>(C.3.1 of UK Code)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Singapore</strong></th>
<th><strong>South Africa</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>The Board should ensure that the members of the AC are appropriately qualified to discharge their responsibilities. Atleast two members should have accounting or related financial management expertise or experience, as the Board interprets such qualification in its business judgement. (Guideline 11.2)</td>
<td>Audit Committee Members should be suitably skilled and experienced independent non-executive directors. (Principle 3.2)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Australia</strong></th>
<th><strong>India</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>The Audit Committee should include members who are all financially literate (that is, be able to read and understand financial statements), atleast one member should have relevant qualifications and experience (that is should be a qualified accountant or other finance professional with experience of financial or accounting matters); and some members should have an understanding of the industry in which the entity operates. (Principle 4, commentary to Recommendation 4.2)</td>
<td>All members of Audit Committee shall be financially literate and atleast one member shall have accounting or related financial management expertise.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Role and responsibilities of Audit Committee</strong></th>
<th><strong>UK</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• To monitor the integrity of the financial statements of the</td>
</tr>
</tbody>
</table>
company, and any formal announcements relating to the company’s financial performance, reviewing significant financial reporting judgements contained in them;

- To review the company’s internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company’s internal control and risk management systems;

- To monitor and review the effectiveness of the company’s internal audit function;

- To make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;

- To review and monitor the external auditor’s independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;

(C.3.2 of UK Code)

**Singapore**

The duties of the AC should include:

a) reviewing the scope and results of the audit and its cost effectiveness, and the independence and objectivity of the external auditors. Where the auditors also supply a substantial volume of non-audit services to the company, the AC should keep the nature and extent of such services under review, seeking to balance the maintenance of objectivity and value for money;

b) reviewing the significant financial reporting issues and judgements so as to ensure the integrity of the financial statements of the company and any formal announcements relating to the company’s financial performance;

c) reviewing the adequacy of the company’s internal controls;

d) reviewing the effectiveness of the company’s internal audit function; and

e) making recommendations to the Board on the appointment, reappointment and removal of the auditor, and approving the remuneration and terms of engagement of the external auditor.

(Guideline 11.4)
South Africa

The Audit Committee should oversee stakeholder reporting (Principle 3.4)

The Audit Committee should satisfy itself of the expertise, resources and experience of the finance division.

The Audit Committee should ensure that a combined assurance model is applied to provide a co-ordinated approach to all assurance activities.

The Audit Committee should be responsible for the oversight of internal audit.

The Audit Committee should be an integral component of the risk management process.

The Audit Committee is responsible for recommending the appointment of the external auditor and the oversight of the external audit process.

The Audit Committee should report to the Board and stakeholder on how its duties have been carried out. (Principle 3.4 – 3.10)

Australia

The Audit Committee should report to the board. The report should contain all matters relevant to the committee’s role and responsibilities, including:

- assessment of whether external reporting is consistent with committee member's information and knowledge and is adequate for shareholder needs
- assessment of the management processes supporting external reporting procedures for the selection and appointment of the external auditor and for the rotation of external audit engagement partners
- recommendations for the appointment or, if necessary, the removal of the external auditor
- assessment of the performance and independence of the external auditors. Where the external auditor provides non-audit services, the report should state whether the audit committee is satisfied that provision of those services has not compromised the auditor’s independence
- assessment of the performance and objectivity of the internal audit function
- the results of the committee’s review of risk management and internal control systems. Principle 7 provides further guidance on this matter
- recommendations for the appointment, or if necessary, the dismissal of the head of internal audit. (Principle 4, Commentary to recommendation 4.3)

India

1. 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.

2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.

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 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.
   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 judgement 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) Qualifications in the draft audit report.

5. Reviewing with the management, the quarterly financial statements before submission to the board for approval.

5A. Reviewing with the management, the statement of uses/application of funds raised through an issue (public issue, right issue, preferential issue etc.), the statement of funds utilised 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 right issue, and making appropriate recommendations to the Board to take up steps in this matter.
6. Reviewing with the management, performance of statutory and internal auditors, adequacy of the internal control systems.

7. 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.

8. Discussion with internal auditors any significant findings and follow up there on.

9. 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.

10. 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.

11. 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.

12. To review the functioning of the Whistle Blower mechanism, in case the same is existing.

13. Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

<table>
<thead>
<tr>
<th>Non-audit services</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The annual report should explain to the shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.</td>
</tr>
</tbody>
</table>

**Singapore**

Where the auditors also supply a substantial volume of non-audit services to the company, the AC should keep the nature and extent of such services under review, seeking to balance the maintenance of objectivity and value for money. (Guideline 11.4(a))

**South Africa**

The Audit Committee has a specific responsibility with regard to the terms of engagement and the level of fees applicable to external audit. This responsibility extends to the conditions under which external audit provide non audit services. (Principle 3.9)
Australia
Where the external auditor provides non-audit services, the report by audit committee to the Board should state whether the audit committee is satisfied that provision of those services has not compromised the auditor’s independence. (Principle 4 and commentary to Recommendation 4.3)

India
Companies act, 2013 brings Auditors independence by disqualifying certain persons such as officers of the company, who are indebted to the company etc., from being appointed as an auditors.

<table>
<thead>
<tr>
<th>Audit Partner Rotation</th>
<th>Australia</th>
<th>The audit committee to report to the board about the procedures for the selection and appointment of the external auditor and for the rotation of external audit engagement partners. (Principle 4, Commentary to Recommendation 4.3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>Rotation of Audit Partner is not mandatory.</td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>No specific provision relating to Audit partner rotation.</td>
<td></td>
</tr>
<tr>
<td>South Africa</td>
<td>No specific provision relating to audit partner. However, the independence of external auditor has been specified.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Improper influence on Auditors</th>
<th>Australia</th>
<th>No specific provision exists.</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>No such provision exists.</td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>No such provision exists.</td>
<td></td>
</tr>
<tr>
<td>South Africa</td>
<td>No specific provision exists.</td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>No specific provision exists.</td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>No provision.</td>
<td></td>
</tr>
</tbody>
</table>

8. Shareholders Rights

<table>
<thead>
<tr>
<th>Shareholder Communication</th>
<th>UK</th>
<th>There should be a dialogue with shareholders based on the</th>
</tr>
</thead>
</table>
mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place. [Section E.1 of UK Code]

**Singapore**

Companies should engage in regular, effective and fair communication with shareholders. (Principle 14)

**South Africa**

Effective communication with stakeholders is essential. (Principle 6.1)

**Australia**

Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation and general meeting and disclose their policy or a summary of that policy. (Principle 6, Recommendation 6.1)

**India**

A number of disclosures to be made in the CG Report has been provided.

---

**Information about directors for election or re-election**

**UK**

The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election. (B7.1)

**Singapore**

Key information regarding directors, such as academic and professional qualifications, shareholding in the company and its subsidiaries, board committees served on (as a member or Chairman), date of first appointment as a director, date of last re-election as a director, directorships or chairmanships both present and those held over the preceding three years in other listed companies and other major appointments, should be disclosed in the annual report. (Guideline 4.6)

**South Africa**

The Board should ensure that the company makes full and timely disclosure of material matters concerning the company. Material matters include the details of directors also. (Principle 1.13)

**Australia**

The names of candidates submitted for election as directors should be accompanied by the following information to enable shareholders to make an informed decision on their election:

- biographical details, including competencies and
qualifications and information sufficient to enable an assessment of the independence of the candidate.
- A statement by the board as to whether it supports the nomination of the proposed candidate(s)
- Details of relationships between:
  • the candidate and the company, and
  • the candidate and directors of the company
- directorships held
- particulars of other positions which involve significant time commitments
  • the terms of office currently served by any directors subject to re-election
  o any other particulars required by law. (Commentary to Recommendation 2.4)

India

(i) In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information:

  a) A brief resume of the director;
  b) Nature of his expertise in specific functional areas;
  c) Names of companies in which the person also holds the directorship and the membership of Committees of the Board; and
  d) Shareholding of non-executive directors as stated above.

9. DISCLOSURES

<table>
<thead>
<tr>
<th>In the Annual Report</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Statement Of How The Board Operates, Including A High Level Statement Of Which Types Of Decisions Are To Be Taken By The Board And Which Are To Be Delegated To Management</td>
<td></td>
</tr>
<tr>
<td>The Names Of The Chairman, The Deputy Chairman (Where There Is One), The Chief Executive, The Senior Independent Director And The Chairmen And Members Of The Nomination, Audit And Remuneration Committees</td>
<td></td>
</tr>
<tr>
<td>The Number Of Meetings Of The Board And Those Committees And Individual Attendance By Directors</td>
<td></td>
</tr>
<tr>
<td>The Names Of Non-Executive Directors Whom The Board</td>
<td></td>
</tr>
</tbody>
</table>
Determines To Be Independent, With Reasons Where Necessary

- The Other Significant Commitments Of The Chairman And Any Changes To Them During The Year

- How Performance Evaluation Of The Board, Its Committees And Its Directors Has Been Conducted

- The Steps The Board Has Taken To Ensure That Members Of The Board, And In Particular The Non-Executive Directors, Develop An Understanding Of The Views Of Major Shareholders About Their Company

- A Separate Section Describing The Work Of The Nomination Committee, Including The Process It Has Used In Relation To Board Appointments And An Explanation If Neither External Search Consultancy Nor Open Advertising Has Been Used In The Appointment Of A Chairman Or A Non-Executive Director

- A Description Of The Work Of The Remuneration Committee As Required Under The Directors’ Remuneration Report Regulations 2002, And Including, Where An Executive Director Serves As A Non-Executive Director Elsewhere, Whether Or Not The Director Will Retain Such Earnings And, If So, What The Remuneration Is

- An Explanation From The Directors Of Their Responsibility For Preparing The Accounts And A Statement By The Auditors About Their Reporting Responsibilities

- A Statement From The Directors That The Business Is A Going Concern, With Supporting Assumptions Or Qualifications As Necessary

- A Report That The Board Has Conducted A Review Of The Effectiveness Of The Group’s System Of Internal Controls

- A Separate Section Describing The Work Of The Audit Committee In Discharging Its Responsibilities

- Where There Is No Internal Audit Function, The Reasons For The Absence Of Such Function

- Where The Board Does Not Accept The Audit Committee’s Recommendation On The Appointment, Re-Appointment Or Removal Of An External Auditor, A Statement From The Audit Committee Explaining The Recommendation And The Reasons Why The Board Has Taken A Different Position; And

- An Explanation Of How, If The Auditor Provides Non-Audit
Services, Auditor Objectivity And Independence Is Safeguarded.

**Singapore**

Disclosures In The Annual Report As Required Under Corporate Governance Code 2005 Covering Various Aspects Such As Remuneration To Directors, Directors’ Independence, Cg Practices, Internal Controls Etc.

**Australia**

The Corporate Governance Principles And Recommendations Covers Various Disclosures To Be Made In The Annual Report With Respect To Directors Appointment, Cg Practices, Internal Control Etc.

**South Africa**


**India**

Disclosures Relating To-

(i) Basis Of Related Party Transactions.
(ii) Disclosure Of Accounting Treatment.
(iii) Board Disclosures – Risk management.
(iv) Proceeds from public issues, right issues, preferential issues etc.
(v) Remuneration of Directors.
(vi) A management Discussion and Analysis Report should part of Annual Report to the shareholders.
(vii) In case of the appointment of a new director or re-appointment of a director, the shareholders must be provided with the brief resume of the director and nature of his expertise in specific functional areas.

<table>
<thead>
<tr>
<th>On the website of the Company</th>
<th><strong>UK</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>• The terms of reference of the nomination, remuneration and audit committees, explaining their role and the authority delegated to them by the board</td>
<td></td>
</tr>
<tr>
<td>• The terms and conditions of appointment of non-executive directors and</td>
<td></td>
</tr>
<tr>
<td>• Where remuneration consultants are appointed, a statement</td>
<td></td>
</tr>
</tbody>
</table>
of whether they have any other connection with the company.

**Australia**

All companies should have a website and are encouraged to communicate with shareholders via electronic methods. If a company does not have a website it must make relevant information available to shareholders by other means, for example, a company may provide the information on request by e-mail, facsimile or post. (Commentary to Recommendation 6.1)

The Corporate Governance principles and recommendation lists a number of items to be published in the website of the company.

**India**

The code of conduct for all Board members and senior management of the company shall be posted on the website of the company.

### 10. OTHERS

<table>
<thead>
<tr>
<th>Whistle blower policy</th>
<th><strong>UK</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Combined code is silent about it.</td>
</tr>
<tr>
<td><strong>Australia</strong></td>
<td>No specific provision exists.</td>
</tr>
<tr>
<td><strong>India</strong></td>
<td>Vigil mechanism is provided.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Risk Management Process</th>
<th><strong>UK</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Audit Committee Has To Review And Assess The Risk Management System.</td>
</tr>
<tr>
<td><strong>Singapore</strong></td>
<td>The Board’s Role Is To Establish A Framework Of Prudent And Effective Controls Which Enables Risk To Be Assessed And Managed. (Guideline 1.1b)</td>
</tr>
<tr>
<td></td>
<td>The Board Should Comment On The Adequacy Of The Internal Controls, Including Financial, Operational And Compliance Controls, And Risk Management Systems In The Company’s Annual Report. (Guideline 12.2)</td>
</tr>
<tr>
<td><strong>South Africa</strong></td>
<td>The Board should be responsible for the process of risk management</td>
</tr>
<tr>
<td></td>
<td>• Risk appetite and risk tolerance levels should be set.</td>
</tr>
<tr>
<td><strong>Key risk areas should be identified.</strong></td>
<td><strong>Key risks should be quantified and monitored. The Board should be involved in this process.</strong> (Principle 1.7)</td>
</tr>
<tr>
<td><strong>Australia</strong></td>
<td></td>
</tr>
<tr>
<td>Companies should establish policies for the oversight and management and management of material business risks and disclose a summary of those policies. (Principle 7 Recommendation 7.1)</td>
<td></td>
</tr>
<tr>
<td><strong>India</strong></td>
<td></td>
</tr>
<tr>
<td>The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures, subject to periodic review.</td>
<td></td>
</tr>
</tbody>
</table>

| **CEO/CFO Certification** | **Australia** |
| Through the Corporate Governance Principles and Recommendations does not have a direct mention on CEO/CFO certification, Section 295A of the Corporate Act deals with declaration from CEO relating to financial records. |  |
| **India** |  |
| The CEO, i.e., the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e., whole time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that: |  |
| • They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief. |  |
| • 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. |  |
| • 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 etc. |  |

| **Code of Conduct/Ethics** | **South Africa** |
| The Board should cultivate and promote an ethical corporate culture. (Principle 2.4) |  |
| **Australia** |  |
| Companies should establish a code of conduct and disclose the code or a summary of the code as to: |  |
| • the practices necessary to maintain confidence in the |  |
company’s integrity

- the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders
- the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

(Principle 3, Recommendation 3.1)

India

The Board shall lay down a code of conduct for all Board members and senior management of the company and the same be posted on the website of the company.

**LESSON ROUND UP**

- The ASX Corporate Governance Council also comprehensively reviewed its principles and issued the third edition of the Principles and Recommendations on 27th March 2014 reflecting global developments in corporate governance and simplifying the structure of the Principles and Recommendations.
- The “if not, why not” approach is fundamental to the operation of the Principles and Recommendations.
- The Principles and Recommendations apply to all ASX listed entities, established in Australia or elsewhere and whether internally or externally managed.
- The ASX listed entity is required under Listing Rule to include in its annual report a corporate governance statement.
- The Principles and Recommendations are structured around, and seek to promote following 8 central principles There are 29 specific recommendations under these general principles.
- The regulatory framework for corporate governance in Singapore is underpinned by corporate law and securities regulations.
- The Listing Manual in Singapore requires listed companies to describe in company’s Annual Reports their corporate governance practices with specific reference to the principles of the Code of Corporate Governance, as well as disclose and explain any deviation from any guideline of the Code.
- MAS issued a revised Code of Corporate Governance on May 2012. The 2012 Code of Corporate Governance superseded and replaced the Code that was issued in July 2005. The Code was effective in respect of Annual Reports relating to financial years commencing from 1 November 2012.
- The Code of Corporate Governance, 2012 comprises of 16 main principles.
- South Africa has opted for a code of principles and practices on a ‘comply or explain’ basis, in addition to certain governance issues that are legislated.
- The release of King III report on 1 September 2009 marked a significant milestone in the evolution of corporate governance in South Africa and brought significant opportunities for organisations that embrace its principles.
- The King III Report has also placed great emphasis on an integrated report, which will evaluate the company’s impact on the economic life of the community in which it operates, as well as many other matters.
- The King III Report on Corporate Governance of South Africa has formulated Code of governance Principles which applies to all entities regardless of the manner and form of incorporation or establishment and whether in the public, private sectors or non-profit sector sectors.
- The development of corporate governance in the UK has its roots in a series of corporate collapses and scandals in the late 1980s and early 1990s.
- The first version of the UK Corporate Governance Code (the Code) was produced in 1992 by the Cadbury Committee.
- The recommendations in the Cadbury Report have been added to at regular intervals since 1992. In 2003 the Code was updated to incorporate recommendations from reports on the role of non-executive directors and the role of the audit committee.
- The FRC has updated the Code at again in 2010 to reflect lessons learnt from the problems in the UK’s financial services sector.
- The Financial Reporting Council (the “FRC”) has published a revised version of the UK Corporate Governance Code containing guidance on risk management and internal controls, remuneration policies and engagement with shareholders in September 2014.
- Whilst primarily aimed at companies with a Premium Listing of shares in the UK, who are required under the Listing Rules to “comply or explain” in their annual report and accounts, the broad principles of the Code may be of interest to other companies who may consider that it would be beneficial to adopt certain of the provisions.
- The UK Corporate Governance Code comprises of 18 main principles.

<table>
<thead>
<tr>
<th>SELF TEST QUESTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Explain the Board Structure recommended under ASX Corporate Governance Principles and Recommendations.</td>
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<tr>
<td>2. Discuss in brief about the remuneration principles of Singapore Corporate Governance Code.</td>
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<td>3. Discuss the functions of Company Secretary provided under the King III Corporate Governance Code for South Africa.</td>
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<td>4. Write a note on ‘Comply &amp; Explain’ approach.</td>
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<td>6. Explain the principles for governance of risks under the King III report.</td>
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Lesson 13
Corporate Social Responsibility

LESSON OUTLINE

- Introduction
- Meaning and definitions
- CSR is not philanthropy
- CSR is a contract with society
- Why csr at all?
- Factors influencing csr
- Triple bottom line approach of csr
- CSR in India
- Corporate social responsibility voluntary guidelines, 2009
- Corporate Social Responsibility under the Companies Act, 2013
- Corporate Citizenship – Beyond The Mandate of Law
- Global Principles And Guidelines
- Corporate Social Responsibility Audit
- Lesson Round-Up
- Self-Test Questions

LEARNING OBJECTIVES

A successful organisation recognizes its responsibility, and duty towards its various stakeholders. Corporate Social Responsibility is the way companies manage their businesses to produce an overall positive impact on society through economic, environmental and social actions. CSR covers wide range of areas such as community investment, workplace diversity and inclusivity, human rights and supply chain management, health and safety, environmental management and climate change, ethics, morality and integrity.

CSR is now high priority for business houses. CSR is no longer viewed as just a regulatory or discretionary cost, but an investment that brings financial returns. It is an opportunity for corporates to gain goodwill. This chapter discusses the importance of adopting CSR in current business environment and the regulatory regime controlling the CSR practices, whether in India or abroad supplemented by case studies and best practices.

"No success in material terms is worthwhile unless it serves the needs or interests of the country and its people".

– JRD Tata
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.

Meaning and Definitions

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: “it 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
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.

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 workforce and their families as well as of the local community and society at large.”

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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 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.

**CSR is not Philanthropy**

Philanthropy means the act of donating money, goods, time or effort to support a charitable cause in regard to a defined objective. Philanthropy can be equated with benevolence and charity for the poor and needy. Philanthropy can be any selfless giving towards any kind of social need that is not served, underserved, or perceived as unserved or underserved. Philanthropy can be by an individual or by a corporate.

It is the active effort to promote human welfare.

Corporate Social Responsibility on the other hand is about how a company aligns their values to social causes by including and collaborating with their investors, suppliers, employees, regulators and the society as a whole. The investment in CSR may be on people centric issues and/or planet issues. A CSR initiative of a corporate is not a selfless act of giving; companies derive long-term benefits from the CSR initiatives and it is this enlightened self interest which is driving the CSR initiatives in companies.

**CSR is a contract with society**

It is the duty of company to undertake CSR activities because company and society are mutually interdependent on each other. No corporation in present world of globalization, liberalization can bear to have indifferent attitude towards the society, isolated existence is not possible.

According to Sir Adrian Cadbury (2002)- “The broadest way of defining social responsibility is to say that the continued existence of companies is based on an implied agreement between business and society. In effect, companies are licensed by society to provide the goods and services which society needs. The freedom of operation of companies is, therefore, dependent on their delivering whatever balance of economic and social benefits society currently expects of them. The problem for companies is that the balance of needs and benefits is continually changing and there is no generally accepted way of measuring those changes.

To start with, companies are expected to meet society’s demands for goods and services, to provide employment, to contribute to the exchequer, and to operate efficiently at a profit. There is no conflict between social responsibility and the obligation on companies to use scarce resources efficiently and to be profitable—an unprofitable business is a drain on society. The essence of the contract between society and business is that companies shall not pursue their immediate profit objectives at the expense of the long-term interests of the community.

**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.

Gaining Recognition: The current generation people are well aware of what goes on around them. People today know a lot about environment, how it affects them, how things we do affects the environment in turn. For the aware and conscientious consumers today, it is important that they buy products that do not harm the environment. They only like to deal with companies that believe and do things for the greater good of planet earth.

CSR IN INDIA

ITC - “e-Choupal”

ITC’s Agri Business Division, one of India’s largest exporters of agricultural commodities, has conceived e-Choupal as a more efficient supply chain aimed at delivering value to its customers around the world on a sustainable basis. e-Choupal model unshackles the potential of Indian farmer who has been trapped in a vicious cycle of low risk taking ability - low investment - low productivity - weak market orientation - low value addition - low margin - low risk taking ability. This made him and Indian agribusiness sector globally uncompetitive, despite rich & abundant natural resources.

‘e-Choupal’ leverages Information Technology to virtually cluster all the value chain participants, Real-time information and customised knowledge provided by ‘e-Choupal’ enhance the ability of farmers to take decisions and align their farm output with market demand and secure quality & productivity. The aggregation of the demand for farm inputs from individual farmers gives them access to high quality inputs from established and reputed manufacturers at fair prices. As a direct marketing channel, virtually linked to the ‘mandi’ system for price discovery, ‘e-Choupal’ eliminates wasteful intermediation and multiple handling. Thereby it significantly reduces transaction costs.
Launched in June 2000, 'e-Choupal', has already become the largest initiative among all Internet-based interventions in rural India. 'e-Choupal' services today reach out to over 4 million farmers growing a range of 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).

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.


The main object of the Factories Act, 1948 was to ensure adequate safety measures and to promote the health and welfare of the workers employed in factories. The Act also makes provisions regarding employment of women and young persons (including children and adolescents), annual leave with wages etc.

The Employees’ State Insurance Act, 1948 provided for certain benefits to employees in case of sickness, maternity and employment injury and also makes provisions for certain other matters in relation thereto.

The Employees Compensation Act, 1923 was a social security legislation. It imposes statutory liability upon an employer to discharge his moral obligation towards his employees when they suffer from physical disabilities and diseases during the course of employment in hazardous working conditions. The Act also seeks to help the dependents of the workmen rendered destitute by the ‘accidents’ and from the hardship arising out from such accidents.
In 1972, the Department of Science and Technology set up a National Committee on Environmental Planning and Coordination to identify and investigate problems of preserving or improving the human environment and also to propose solutions for environmental problems. In 1977, by an amendment to the Constitution, Article 48A was introduced imposing a duty on the State to protect and improve the environment and safeguard the forests and wildlife of the country. Article 51A also, provided for the protection and improvement of the natural environment including forests, lakes, rivers and wildlife and to have compassion for living creatures.

In 1986, the Government enacted the Environment Protection Act to provide for the protection and improvement of environment and the prevention of hazards to human beings, other living creatures, plants and property.

The Ministry of Corporate Affairs has adopted the role of an enabler, facilitator and regulator for effective functioning and growth of the corporate sector. A number of initiatives have been taken on the legislative, service delivery and capacity building sides so that the corporate sector is provided with a buoyant and enabling regulatory environment for its growth. Simultaneously, the Ministry is also focusing on various issues related to inclusive growth in relation to the development of corporate sector.

**CORPORATE SOCIAL RESPONSIBILITY VOLUNTARY GUIDELINES, 2009**

The Ministry of Corporate Affairs issued the Corporate Social Responsibility Voluntary Guidelines, 2009 which was a 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.

Corporate Social Responsibility Voluntary Guidelines, 2009 provided that each business entity should formulate a CSR policy to guide its strategic planning and provide a roadmap for its CSR initiatives, which should be an integral part of overall business policy and aligned with its business goals. The policy should be framed with the participation of various level executives and should be approved by the Board.

The CSR Policy should normally cover following core elements:

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<tr>
<th>1. Care for all Stakeholders</th>
<th>The companies should respect the interests of, and be responsive towards all stakeholders, including shareholders, employees, customers, suppliers, project affected people, society at large etc. and create value for all of them. They should develop mechanism to actively engage with all stakeholders, inform them of inherent risks and mitigate them where they occur.</th>
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<td>2. Ethical functioning</td>
<td>Their governance systems should be underpinned by Ethics, Transparency and Accountability. They should not engage in business practices that are abusive, unfair, corrupt or anti-competitive.</td>
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<td>3. Respect for Workers’ Rights and Welfare</td>
<td>Companies should provide a workplace environment that is safe, hygienic and humane and which upholds the dignity of employees. They should provide all employees with access to training and development of necessary skills for career advancement, on an equal and non-discriminatory basis. They should uphold the freedom of association and the effective recognition of the right to collective bargaining of labour, have an effective grievance redressal system, should not employ child or forced labour and provide and maintain equality of opportunities without any discrimination on any grounds in recruitment and during employment.</td>
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4. Respect for Human Rights
Companies should respect human rights for all and avoid complicity with human rights abuses by them or by third party.

5. Respect for Environment
Companies should take measures to check and prevent pollution; recycle, manage and reduce waste, should manage natural resources in a sustainable manner and ensure optimal use of resources like land and water, should proactively respond to the challenges of climate change by adopting cleaner production methods, promoting efficient use of energy and environment friendly technologies.

6. Activities for Social and Inclusive Development
Depending upon their core competency and business interest, companies should undertake activities for economic and social development of communities and geographical areas, particularly in the vicinity of their operations. These could include: education, skill building for livelihood of people, health, cultural and social welfare etc., particularly targeting at disadvantaged sections of society.

The CSR policy of the business entity should provide for an implementation strategy which should include identification of projects/activities, setting measurable physical targets with timeframe, organizational mechanism and responsibilities, time schedules and monitoring. Companies may partner with local authorities, business associations and civil society/non-government organizations. They may influence the supply chain for CSR initiative and motivate employees for voluntary effort for social development. They may evolve a system of need assessment and impact assessment while undertaking CSR activities in a particular area. Independent evaluation may also be undertaken for selected projects/activities from time to time.

Companies should allocate specific amount in their budgets for CSR activities. This amount may be related to profits after tax, cost of planned CSR activities or any other suitable parameter.

To share experiences and network with other organizations the company should engage with well established and recognized programmes/platforms which encourage responsible business practices and CSR activities. This would help companies to improve on their CSR strategies and effectively project the image of being socially responsible.

The companies should disseminate information on CSR policy, activities and progress in a structured manner to all their stakeholders and the public at large through their website, annual reports, and other communication media.

Thus, an effective CSR policy may include:

- Vision: The CSR vision of the company should be such that it defines the purpose of the company’s CSR initiatives; and defines the company’s CSR goal. The CSR vision should be well aligned to the business goals so that it benefits the company as well.
- Implementation guidance: Implementation Guidance consisting of-
  - Identification of thrust areas
  - Identification of manner and nature of projects/activities
  - Defining measurable targets & time frame for the activities
  - Performance Management: Quality and standard of the work to be maintained
  - Organisational Mechanism & Assigning responsibilities for due performance of the CSR
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Projects

- Manner of Delivering CSR: Foundation/Partnership with Non Government Organisation/Participation of Employees
  - Fund Resources: Budget Allocation and its utilization
  - Medium of Dissemination of information on CSR
  - Management Commitment

National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011

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. The document also said that “after considering the experience of the adoption of these Guidelines by the Indian corporate sector and consideration of relevant feedback and other related issues, the Government may initiate the exercise for review of these Guidelines and further improvement after one year.

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:
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<th><strong>Principles</strong></th>
<th><strong>Core Elements</strong></th>
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| **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
### 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.
| 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:**

This principle is based on the fact that the basic aim of a business
Businesses should engage with and provide value to their customers and consumers in a responsible manner. The 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.

Business Responsibility Report

In line with the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business and considering the larger interest of public disclosure regarding steps taken by listed entities from an Environmental, Social and Governance ("ESG") perspective, SEBI decided to mandate inclusion of Business Responsibility Reports ("BR reports") as part of the Annual Reports for listed entities. The detail of framework of Business responsibility report is discussed in Lesson 15 –Corporate Sustainability reporting Frameworks”.

CORPORATE SOCIAL RESPONSIBILITY UNDER THE COMPANIES ACT, 2013

The Companies Act, 2013 has introduced the concept of Corporate Social Responsibility in India to the forefront. It aims to promote greater transparency and disclosure. The Ministry of Corporate Affairs notified Section 135 and Schedule VII of the Companies Act 2013 as well as the Companies (Corporate Social Responsibility Policy) Rules, 2014 which came into effect from April 1, 2014. The MCA further issued Circular No. 21/2014 and 36/2014 to clarify on certain matters. Notification making further amendments in Schedule VII was issued on August 2014 and Companies (Corporate Social Responsibility Policy) Amendment Rules, 2015 were released on January 2015. The provisions of the Act and the Rules amended till July 2015 are given below-

Definition of CSR

The term ‘CSR’ is defined in the Companies (Corporate Social Responsibility Policy) Rules to mean and
include but not limited to:

- projects or programs relating to activities specified in the Schedule VII of the Act; or
- projects or programs relating to activities undertaken by the Board in pursuance of recommendations of the CSR Committee as per the declared CSR policy subject to the condition that such policy covers subjects enumerated in the Schedule VII of the Act.

**Applicability**

As per section 135 of the Companies Act 2013, the CSR provision will be applicable companies which fulfills any of the following criteria during any of the three preceding financial years =

- Companies having net worth of rupees five hundred crore or more, or
- Companies having turnover of rupees one thousand crore or more or
- Companies having a net profit of rupees five crore or more

The CSR Rules have widen the ambit for compliance obligations to include the holding and subsidiary companies as well as foreign companies whose branches or project offices in India which fulfills the criteria specified above.

According to the CSR Rules, the CSR provision will also be applicable to every company including its holding or subsidiary, and a foreign company having its branch office or project office in India having net worth of rupees five hundred crore (500 Crore) or more, or turnover of rupees one thousand crore (1000 crore) or more or a net profit of rupees five crore (5 Crore) or more during any financial year.

If a company ceases to be a company covered under subsection (1) of section 135 of the Act for three consecutive financial years shall not be required to -

1. constitute a CSR Committee; and
2. comply with the provisions contained in sub-section (2) to (5) of the said section till such time it meets the criteria specified in sub-section (1) of section 135.

Thus, the CSR Rules specify that a company which does not satisfy the specified criteria for a consecutive period of three financial years is not required to comply with the CSR obligations, implying that a company not satisfying any of the specified criteria in a subsequent financial year would still need to undertake CSR activities unless it ceases to satisfy the specified criteria for a continuous period of three years. This could increase the burden on small companies which do not continue to make significant profits.

**CSR Committee**

Companies that trigger any of the aforesaid conditions must constitute a Corporate Social Responsibility Committee of the Board to formulate and monitor the CSR policy of a company. Section 135 of the 2013 Act requires the CSR Committee to consist of at least three directors, including at least one independent director. However, CSR Rules exempts unlisted public companies and private companies that are not required to appoint an independent director from having an independent director as a part of their CSR Committee.

Further, the CSR Rules have relaxed the requirement regarding the presence of three or more directors on the CSR Committee of the Board. In case where a private company has only two directors on the Board, the CSR Committee can be constituted with these two directors.

The CSR Committee of a foreign company shall comprise of at least two persons wherein one or more persons should be resident in India and the other person nominated by the foreign company.
The Board's report shall disclose the composition of the Corporate Social Responsibility Committee.

**Functions of the CSR Committee**

- The Corporate Social Responsibility Committee shall formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII.
- The Corporate Social Responsibility Committee shall recommend the amount of expenditure to be incurred on the activities to be undertaken by the company as specified in Schedule VII.
- Further, the CSR Committee is under an obligation to monitor the implementation of the CSR policy from time to time.
- The CSR Committee shall also institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the government.

**CSR Policy**

CSR Policy relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company.

The Rules provide that the CSR Policy of a company shall, inter alia include the following, namely:

- A list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedule for the same; and
- Monitoring process of such projects or programs.

But the activity should not be undertaken in pursuance of normal course of business of a company. The Board shall ensure that the activities included by the company in its CSR Policy are related to the activities mentioned in Schedule VII of the Act.

The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of business profit of a company.

The Board after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company’s website. The Board of every company ensures that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

**CSR Expenditure**

- The Board of every company shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. This amount will be CSR expenditure.
- If the company fails to spend such amount, the Board shall, in its report specify the reasons for not spending the amount.
- The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.
○ Expenditure incurred on specified activities that are carried out in India only will qualify as CSR expenditure. Such expenditure includes contribution to the corpus or on projects or programs relating to CSR activities.

○ Expenditure incurred in undertaking normal course of business will not form a part of the CSR expenditure. Companies would need to clearly distinguish those activities which are undertaken specifically in pursuance of normal course of business and those that are done incrementally as part of the CSR initiatives.

○ Any surplus arising out of CSR activities will not be considered as business profit for the spending company.

○ Expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spend of the Indian subsidiary if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so as per section 135 of the Act.

CSR Activities

○ The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

○ The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered trust or a registered society or a company established under section 8 of the Act by the company, either singly or along with its holding or subsidiary or associate company, or along with any other company or holding or subsidiary or associate company of such other company, or otherwise. Provided that----

(i) If such trust, society or company is not established by the company either singly or along with its holding or subsidiary or associate company, or along with any other company or holding or subsidiary or associate company of such other company or its holding or subsidiary or associate company, it shall have an established track record of three years in undertaking similar programs or projects:

(ii) the company has specified the projects or programs to be undertaken through these entities, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism.

○ A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs in accordance with these rules.

○ The CSR projects or programs or activities undertaken in India only shall amount to CSR Expenditure.

○ The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

○ Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through institutions with established track records of at least three financial years but such expenditure (including expenditure on administrative overheads) shall not exceed five percent of total CSR expenditure of the company in one financial year.

○ Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.
List of CSR Activities

Some activities are specified in Schedule VII as the activities which may be included by companies in their Corporate Social Responsibility Policies. The entries in the said Schedule VII must be interpreted liberally so as to capture the essence of the subjects enumerated in the said Schedule. The items enlisted in the amended Schedule VII of the Act, are broad-based and are intended to cover a wide range of activities as illustratively. These are activities related to:

(i) eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water.

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

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

(iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agro forestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga;

(v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

(vi) measures for the benefit of armed forces veteran, war widows and their dependents;

(vii) training to promote rural sports nationally recognized sports and Olympic sports;

(viii) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

(ix) contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;

(x) rural development projects.

(xi) slum area development where ‘slum area’ shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force.

However, in determining CSR activities to be undertaken, preference would need to be given to local areas and the areas around where the company operates.

As per Clarification issued by MCA on 18th June, 2014; following may be noted with regard to provisions mentioned under section 135:

One-off events such as marathons/ awards/ charitable contribution/ advertisement/ sponsorships of TV programmes etc. do not be qualified as part of CSR expenditure.

Expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Labour Laws,
Land Acquisition Act etc.) are not count as CSR expenditure under the Companies Act.

### Computation of net profit

The net worth, turnover and net profits are to be computed in terms of Section 198 of the 2013 Act as per the profit and loss statement prepared by the company in terms of Section 381 (1) (a) and Section 198 of the 2013 Act. Every company will have to report its standalone net profit during a financial year for the purpose of determining whether or not it triggers the threshold criteria as prescribed under Section 135(1) of the Companies Act.

- **Indian company:** The CSR Rules have clarified the manner in which a company’s net worth will be computed to determine if it fits into the ‘spending’ norm. In order to determine the ‘net profit’, dividend income received from another Indian company or profits made by the company from its overseas branches have been excluded. Moreover, the 2% CSR is computed as 2% of the average net profits made by the company during the preceding three financial years.

- **Foreign company:** The CSR Rules prescribe that in case of a foreign company that has its branch or a project office in India, CSR provision will be applicable to such offices. CSR Rules further prescribe that the balance sheet and profit and loss account of a foreign company will be prepared in accordance with Section 381(1)(a) and net profit to be computed as per Section 198 of the Companies Act. It is not clear as to how the computation of net worth or turnover would be arrived at in case of a branch or project office of a foreign company.

It has been clarified that if net profits are computed under the Companies Act, 1956 they needn't be recomputed under the 2013 Act. Profits from any overseas branch of the company, including those branches that are operated as a separate company would not be included in the computation of net profits of a company. Besides, dividends received from other companies in India which need to comply with the CSR obligations would not be included in the computation of net profits of a company.

### Disclosure Requirements

It is mandatory for companies to disclose in Board’s Report, an annual report on CSR. The report of the Board of Directors attached to the financial statements of the Company would also need to include an annual report on the CSR activities of the company in the format prescribed containing following particulars –

- A brief outline of the company’s CSR policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs.
- The Composition of the CSR Committee.
- Average net profit of the company for last three financial years
- Prescribed CSR Expenditure
- Details of CSR spent during the financial year.
- In case the company has failed to spend the two per cent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board report.
- A responsibility statement of the CSR Committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and Policy of the company.

If the company has been unable to spend the minimum required on its CSR initiatives, the reasons for not doing so are to be specified in the Board Report. If a company has a website, the CSR policy and the report containing details of such activities have to be made available on the company’s website for informational purposes.
FORMAT FOR THE ANNUAL REPORT ON CSR ACTIVITIES TO BE INCLUDED IN THE BOARD REPORT

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 last three financial years.

4. Prescribed CSR Expenditure (two percent 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:

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<td>Amount outlay (budget) project or programs wise</td>
<td>Amount spent on the projects or programs Sub-heads: (1) Direct expenditure on projects or programs (2) Overheads:</td>
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Give details of implementing agency

6. In case the company has failed to spend the two percent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board report.

7. A responsibility statement of the CSR committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and policy of the company.

Sd/- (Chief Executive Officer or Managing Director or Director)  Sd/- (Chairman CSR Committee)  Sd/- (Person specified under clause (d) of sub section (1) of section 380 of the Act) (wherever applicable)

CORPORATE CITIZENSHIP – BEYOND THE MANDATE OF LAW

Corporate citizenship is a commitment to improve community well-being through voluntary business practices and contribution of corporate resources leading to sustainable growth. Corporate responsibility is achieved when a business adapts CSR well aligned to its business goals and meets or exceeds, the ethical, legal, commercial and public expectations that society has of business.
The term corporate citizenship implies the behaviour, which would maximize a company’s positive impact and minimize the negative impact on its social and physical environment. It means moving from supply driven to more demand led strategies; keeping in mind the welfare of all stakeholders; more participatory approaches to working with communities; balancing the economic cost and benefits with the social; and finally dealing with processes rather than structures. The ultimate goal is to establish dynamic relationship between the community, business and philanthropic activities so as to complement and supplement each other.

Corporate citizenship is being adopted by more companies who have come to understand the importance of the ethical treatment of stakeholders.

**Tata Steel – A company that also makes steel**

Tata Steel’s Vision strikes a balance between economic value as well as ecological and societal value by aspiring to be "a Global Benchmark in Value Creation and Corporate Citizenship". In the initial years, Tata Steel's CSR interventions were more as a 'provider' to society where the community was given support for its overall needs, both for sustenance and development. Gradually, the shift in approach led to Tata Steel being an 'enabler' focusing on building community capacity through training programmes; focusing on providing technical support rather than giving aid. At present, CSR interventions of Tata Steel focus on 'sustainable development' to enhance the quality of life of people. It guides the Company in its race to excel in all areas of sustainability. J R D Tata the Chairman of the Tata Group believed that, "to create good working conditions, to pay the best wages to its employees and provide decent housing to its employees are not enough for the industry, the aim of an industry should be to discharge its overall social responsibilities to the community and the society at large, where industry is located."

Guided by this mandate, Tata Steel has for decades uses its skills and resources, to the extent it can reasonably afford, to give back to the community a fair share of the product of its efforts.

It was the first to establish labour welfare practices, even before these were made statutory laws across the world. The Company also instituted an eight-hour workday in 1912, free medical aid in 1915, a Welfare Department in 1917, leave with pay, Workers Provident Fund and Workmen’s Compensation in 1920 and Maternity Benefit for ladies in 1928.

The Company supports and propagates the principles of the United Nations Global Compact as a Founder Member, is a signatory to the Worldsteel Sustainability Charter and supports the Affirmative Action programme of the Confederation of Indian Industry.

Tata Steel’s approach to business has evolved from the concept that the wealth created must be continuously returned to society. The responsibility of combining the three elements of society - social, environmental, and economic - is of utmost importance to the way of life at Tata Steel. Today, Tata Steel’s CSR activities in India encompass the Company’s Steel Works, Iron ore mines and collieries, reaching out to the city of Jamshedpur, its peri-urban areas and over 800 villages in the states of Jharkhand, Odisha and Chhattisgarh. Community involvement is a characteristic of all Tata Steel Group companies around the world. It can take the form of financial support, provision of materials and the involvement of time, skills and enthusiasm of employees. The Group contributes to a very wide range of social, cultural, educational, sporting, charitable and emergency assistance programmes.

The Company works in partnership with the Government, national and international development organisations, local NGOs and the community to ensure sustainable development. The Corporate Services Division 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.

UNGC

UNGC is world’s largest corporate citizenship initiative with the objective to mainstream the adoption of sustainable and socially responsible policies by businesses around the world. The 10 principles of the UN Global Compact have been derived from various UN conventions such as the Universal Declaration of Human Rights, ILO’s Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on environment and development, and the UN Convention against Corruption. These principles cover four broad areas:

- Human rights (support and respect the protection of international human rights and ensure that business is not complicit with human rights abuses)
- Labour rights (uphold the freedom of association and effective recognition of the right to collective bargaining, elimination of all forms of forced and compulsory labour, effective abolition of child labour and elimination of description in respect of employment and occupation)
- Environment (support a precautionary approach to environmental challenges, undertake initiatives to promote greater environmental responsibility and encourage the development of environmental friendly technology)
- Governance (work against corruption in all forms, including bribery and extortion).
The UN Guiding Principles on Business and Human Rights

The UN guiding principles provide assistance to states and businesses to fulfil their existing obligations towards respecting and protecting human rights and fundamental freedoms and comply with the existing laws. These principles act as global standards for addressing the risk of human rights violation related to business activity. In circumstances when these laws are breached or the guidance is not adhered to, suitable remedies have also been recommended. The primary focus is on the protection of human rights by both, the state and the business enterprises, and the principles broadly outline the manner in which the framework can be implemented.

OECD Guidelines: Multinational enterprises

OECD Guidelines for multinational enterprises elaborate on the principles and standards for responsible business conduct for multinational corporations. These guidelines were recently updated in 2011. They cover areas such as employment, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition and taxation. They contain defined standards for socially and environmentally responsible corporate behaviour, and also provide procedures for resolving disputes between corporations and communities or individuals adversely impacted by business activities.

Institute of Social and Ethical Accountability: AccountAbility’s AA1000 series of standards

This is a series of standards which enable organisations to become accountable, responsible and sustainable. It consists of the (i) AA1000 accountability principles (AP) standard (ii) AA1000 assurance standard (AS) (iii) AA1000 stakeholder engagement (SE) standard. Since these standards have been formulated through a multi-stakeholder consultation process, they ensure that those impacted (that is, enterprises, governments and civil societies) stand to gain. The Vodafone Group Plc has adopted the AA1000AP standard by focusing on three broad areas: (i) inclusivity (stakeholder engagement to develop and implement a strategic approach to sustainability) (ii) materiality (assess the management effort required for each material issue and determine the content of sustainability reports) (iii) responsiveness (respond with solutions to material issues and challenges).

Social Accountability International (SAI): SA 8000 Standard

This is one of the world’s first auditable social certification standard. It is based on ILO, UN and national law conventions, and adopts a management system approach in order to ensure that companies that adopt this approach also comply with it. This standard ensures the protection of basic human rights of workers. The nine basic elements of this standard include (i) child labour (ii) forced and compulsory labour (iii) health and safety (iv) freedom of association and the right to collective bargaining (v) discrimination (vi) disciplinary practices (vii) working hours (viii) remuneration (ix) management systems. According to SAAS, there are 695 facilities in India that have been accredited with this standard. Out of these, Aditya Birla Chemicals (India) Limited, Bhilai Steel Plant Steel Authority of India Limited, Birla tyres, Dr Reddy’s Laboratories Limited and Reliance Infrastructure Limited figure prominently in the list of certified facilities within India.

ISO 26000: Social responsibility

ISO 26000 is the international standard giving guidance on social responsibility and is intended for use by organizations of all types both public and private sectors, in developed and developing countries. It provides guidance on principles of social responsibility, the core subjects and issues pertaining to social responsibility and on ways to integrate socially responsible behaviour into existing organizational strategies, systems, practices and processes.
This is a guidance tool provided by the ISO which enables organisations to understand the meaning and significance of social responsibility. It is important to note that this is not a certification but only a guiding tool. Hence, organisations which comply with these standards are self-certified. It covers six core areas of social responsibility, including (i) human rights (ii) labour practices (iii) environment (iv) fair operating practices (v) consumer issues (vi) community involvement and development. This ensures a holistic approach to the concept of social responsibility and sustainable development.

It intends to assist organizations in contributing to sustainable development. It is intended to encourage them to go beyond legal compliance, recognizing that compliance with law is a fundamental duty of any organization and an essential part of their social responsibility. It is intended to promote common understanding in the field of social responsibility, and to complement other instruments and initiatives for social responsibility, not to replace them.

ISO 26000 is not a management system standard. It is not intended or appropriate for certification purposes or regulatory or contractual use.

**Global Compact Self-Assessment Tool**

The Global Compact Self Assessment Tool is an easy-to-use guide designed for use by companies of all sizes and across sectors committed to upholding the social and environmental standards within their respective operations. The tool consists of 45 questions with a set of three to nine indicators for each question. It consists of a ‘management section’ and four other sections, including human rights, labour, environment and anti-corruption that relate to the principles of the UN Global Compact. The tool is in line with the UN Guiding Principles on Business and Human Rights. For a small company, this tool acts as a measure of the company’s performance in all areas of the UN Global Compact and how well these issues are managed. For a large organisation, this tool helps to continuously improve existing policies and systems, engage subsidiaries, suppliers or other stakeholders, and improves internal and external reporting.

**CORPORATE SOCIAL RESPONSIBILITY AUDIT**

A Corporate Social Responsibility audit aims at identifying environmental, social or governance risks faced by the organization and evaluating managerial performance in respect of those. Corporate Social Responsibility (“CSR”) is a broad term however, for the purpose of addressing the scope of a CSR Audit, CSR is about managing and taking into consideration organization’s operational, processes and behavioral impact on society and stakeholders from a broad perspective. Contrary to common belief CSR is more than basic legal compliance and is highly connected with and affects organization’s bottom line.

In order to ascertain an organizations effective CSR policy, practices and culture, the notion of auditing CSR in organizations is becoming key. However, this requires a substantial shift in the audit profession to include beyond the traditional lines of finance and information technology to wider operational practices that respond to client and professional pressures brought about by a growth in the practice of risk management. Audits and the process of auditing as we commonly know it is focused on the organizations achievement of its stated and communicated objective; its compliance with rules, regulations and legislation; the reliability of its records and information accessible to the public or communicated to the public; the safeguard of its assets. This does not address CSR or CSR related risks. The risks of not paying adequate attention to CSR are clear – reputation damage, lawsuits, and government scrutiny. Internal audit should focus on these risks and assist management to identify appropriate actions. This called for a different approach to audit and in particular an audit that takes into consideration health, safety, environmental, reputational and business probity not to mention CSR governance.

CSR audit has yet to gain momentum but the concept aims to give an independent opinion by external auditor, on the extent of alignment of CSR objectives with the business goals and level of managerial
commitment and performance with regard to attainment of social responsibility objectives defined by the company’s Board.

An internal audit that is intended to cover CSR should start by creating an understanding of the social responsibility issues that affect the organization and its industry. Following that, the audit should review how management reconciles these sometimes-contrary needs. A CSR audit program can cover all or any of the following risks: - Effectiveness of the operating framework for CSR implementation - Effectiveness of implementation of specific, large CSR projects - Adequacy of internal control and review mechanisms - Reliability of measures of performance - Management of risks associated with external factors like regulatory compliance, management of potential adverse NGO attention, etc. An Indicative CSR Audit Programme is given below:

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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.

- A CSR initiative of a corporate is not a selfless act of giving; companies derive long-term benefits from the CSR initiatives and it is this enlightened self interest which is driving the CSR initiatives in companies.

- The Ministry of Corporate Affairs has adopted the role of an enabler, facilitator and regulator for effective functioning and growth of the corporate sector.

- The Ministry of Corporate Affairs issued the Corporate Social Responsibility Voluntary Guidelines, 2009 which was a 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.

- 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.

- The Companies Act, 2013 has introduced the concept of Corporate Social Responsibility in India to the forefront. the CSR provision will be applicable companies which fulfills any of the following criteria during any of the three preceding financial years.
  - 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

- Section 135 of the 2013 Act requires the CSR Committee to consist of at least three directors, including at least one independent director. The Corporate Social Responsibility Committee shall formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII.

- The Board of every company shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. This amount will be CSR expenditure.

- The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

- The net worth, turnover and net profits are to be computed in terms of Section 198 of the 2013 Act as per the profit and loss statement prepared by the company in terms of Section 381 (1) (a) and Section 198 of the 2013 Act. It is mandatory for companies to disclose in Board’s Report, an annual report on CSR. The report of the Board of Directors attached to the financial statements of the Company would also need to include an annual report on the CSR activities of the company in the format prescribed.

- A Corporate Social Responsibility audit aims at identifying environmental, social or governance risks faced by the organization and evaluating managerial performance in respect of those. Corporate Social Responsibility (“CSR”) is a broad term however, for the purpose of addressing the scope of a CSR Audit.
## SELF-TEST QUESTIONS

1. **Why CSR? Elaborate.**
2. **What are the factors influencing CSR?**
3. **Discuss the provision with regard to CSR in terms of Companies Act, 2013.**
4. **Explain with the help of an example on how CSR can be integrated with business goals?**
**LESSON OUTLINE**

- Introduction
- Sustainable Development
- Role of Business in Sustainable Development
- Sustainability Terminologies
- Corporate Sustainability
- Corporate Sustainability and Corporate Social Responsibility
- Kyosei
- Triple Bottom Line (TBL)
- Conclusion
- Lesson Round-Up
- Self Test Questions

**LEARNING OBJECTIVES**

The objective of this study lesson is to enable the students to understand the concept of sustainability, its meaning and scope, and familiarize them with sustainability terminologies being used widely.

The study focuses on the Corporate Sustainability and the role corporate & other stakeholders play in promoting a sustainable development. It also highlights the initiatives taken by the government to improve sustainability reporting.

This lesson will enable the students to recognize the difference between CSR and Sustainability, and the concept of Triple Bottom Line (TBL).

“People 'over-produce' pollution because they are not paying for the costs of dealing with it.”

*Ha-Joon Chang.*
INTRODUCTION

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

Sustainability is important to make sure that we have and will continue to have the water, materials, and resources to protect human health and our environment.

Sustainability has been comprehensively defined in Paul Hawkin’s book – The Ecology of Commerce as:

“Sustainability is an economic state where the demand placed upon the environment by people and commerce can be met without reducing the capacity of the environment to provide for future generations. It can also be expressed in the simple terms of an economic golden rule for the restorative economy; leave the world better than you found it, take no more than you need, try not to harm life of environment, make amends if you do.”

SUSTAINABLE DEVELOPMENT

Sustainable development is a broad concept that balances the need for economic growth with environmental protection and social equity. It is a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are all in harmony and enhance both current and future potential to meet human needs and aspirations. Sustainable development is a broad concept and it combines economics, social justice, environmental science and management, business management, politics and law.

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.

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.

WCED recognized that the achievement of sustainable development could not be simply left to government regulators and policy makers. It recognized that the industry has a significant role to play in it. While corporates are the drivers for economic development, they are required to be more proactive in balancing this with social equity and environmental protection. This is all the more so because on the one hand it has been majorly responsible for some of the unsustainable conditions, and one the other they have access to the resources necessary to address the problems.

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 Principles 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 intergenerational 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 question is whether we can live in harmony with the environment without warming the planet by sending more greenhouse gases into the atmosphere and without contributing to the current ongoing mass extinction of animals and plants, or not.

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.

### Role of Business in Sustainable Development

Trade and industry being an integral part human society has a pivotal role to play in this direction. United Nations has already initiated UN Global Compact, 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. With such commitment a business can ensure that markets, commerce, technology and finance can advance together in ways that would benefit economies and societies universally.

This is the first initiative which has aligned the business world to common goals, such as building markets, combating corruption, safeguarding the environment and ensuring social inclusion. It has resulted in unprecedented partnerships and openness among business, government, civil society, labour and the United Nations. Over 4700 corporates from over 130 countries have become participants of Global compact.

The Global Compact is a policy framework for the development, implementation, and disclosure of
sustainability principles and practices designed to establish sustainable business models and markets building, inclusive of global economy.

The UN Global Compact has two objectives:

1. Ten principles in business activities around the world.
2. Catalyze actions in support of broader UN goals, including the Millennium Development Goals (MDGs).

The initiative is voluntary in nature. The benefits of engagement include the following:

- Adopting an established and globally recognized policy framework for the development, implementation, and disclosing environmental, social, and governance policies and practices.
- Sharing best and emerging practices to advance practical solutions and strategies to common challenges.
- Advancing sustainability solutions in partnership with a range of stakeholders, including UN agencies, governments, civil society, labour, and other non-business interests.
- Linking business units and subsidiaries across the value chain with the Global Compact’s Local Networks around the world - many of these are operating in developing and emerging markets.
- Accessing the United Nations’ extensive knowledge of and experience with sustainability and development issues.
- Utilizing UN Global Compact management tools and resources, and the opportunity to engage in specialized work streams in the environmental, social and governance realms.

To summarize, the Global Compact exists to assist the private sector in the management of increasingly complex risks and opportunities in the environmental, social and governance realms. By partnering with companies in this way, and leveraging the expertise and capacities of a range of other stakeholders, the Global Compact seeks to embed markets and societies with universal principles and values for the benefit of all.

**SUSTAINABILITY TERMINOLOGIES**

**Carbon footprint**

A carbon footprint is an estimate of how much carbon is produced to support your lifestyle. Essentially, it measures your impact on the climate based on how much carbon you produce. Factors that contribute to your carbon footprint include travel methods and general home energy usage. Carbon footprints can also be applied on a larger scale to companies, businesses and even countries. The word ‘carbon’ in the phrase ‘carbon footprint’ is often used as a short-cut to describe the main greenhouse gases - carbon dioxide (CO₂), methane and nitrous oxide - in terms of carbon dioxide equivalents.

**Carbon offsetting**

Carbon offsets are used to reduce the amount of carbon that an individual or institution emits into the atmosphere. Carbon offsets work in a financial system where, instead of reducing its own carbon use, a company can comply with emissions caps by purchasing an offset from an independent organization. The organization will then use that money to fund a project that would reduce carbon in the atmosphere. An individual can also engage himself with this system, and similarly pay to offset his or her own personal carbon usage, instead of or in addition to, taking direct measures such as driving less or recycling.
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**Carbon Neutral**

Through carbon offsetting organisations to the individuals are counterbalancing the emissions they produce to make themselves carbon neutral.

**Clean Development Mechanism (CDM)**

UN regulated scheme that allows countries with an emission-reduction or emission-limitation commitment under the Kyoto Protocol to implement an emission-reduction project in developing countries.

**Cradle to grave**

The life of a product, from creation to end use.

**Cradle to cradle**

Using an end use product as the source of a new product.

**Ecological Footprint**

The ecological footprint is a measure of human demand on the earth's ecosystems. It compares human demand with planet earth's ecological capacity to regenerate it. It represents the amount of biologically productive land and sea area needed to regenerate the resources a human population consumes and to absorb and render the corresponding waste harmless, given prevailing technology and resource management practices.

**Environmental Performance Index**

Environmental Performance Index (EPI) is a method of quantifying and numerically benchmarking the environmental performance of a country's policies. This index was developed from the Pilot Environmental Performance Index, first published in 2002, and it has been designed to supplement the environmental targets set forth in the U.N. Millennium Development Goals.

**Energy Star**

Energy Star is a program that evaluates the energy efficiency of appliances, house fixtures and other home utilities.

**Ethical consumerism**

The purchasing of products that do not harm or exploit the workers who help produce a product, and to minimise their impact on the environment.

**EUI**

EUI, or energy use intensity, is a unit of measurement that describes a building’s energy use. EUI represents the energy consumed by a building relative to its size.

**Global Warming**

Global warming is an average increase in the temperature of the atmosphere near the Earth’s surface and in the troposphere, which can contribute to changes in global climate patterns. Global warming can occur from a variety of causes, both natural as well as human induced. In common usage, “global warming” often refers to the warming that can occur as a result of increased emission of greenhouse gases as a result of human
activities. See climate change, greenhouse effect, enhanced greenhouse effect, radiative forcing and troposphere.

**Greenhouse effect**

Gases produced naturally and as a result of human activities that have contributed to the warming of the planet, known as Global warming, by trapping the sun’s rays.

**Greenwashing**

Greenwashing is a form of corporate misrepresentation where a company will present a green public image and publicize green initiatives that are false or misleading. A company might release misleading claims or even true green initiatives while privately engaging in environmentally damaging practices. Companies are trying to take advantage of the growing public concern and awareness for environmental issues by promoting an environmentally responsible image. Greenwashing is used by companies to win over investors (especially those interested in socially responsible investing), create competitive advantage in the marketplace, and convince critics that the company is well-intentioned. There is a profit-driven motive to greenwashing as well—green products are among the fastest growing segments in the market. Internationally, the increase in green advertising claims has become a cause for concern.

**Life Cycle Assessment**

Life Cycle Assessment tracks the environmental impact of a product from the use of its raw materials to its disposal at the end of its useful life. LCA is an important tool for developing an environmental self-portrait and for finding ways to minimize harm. A good LCA can shed light on ways to reduce the resources consumed and lower costs all along the value chain.

A Life Cycle Assessment looks at this complete circle and measures environmental impact at every phase. It provides the foundation for understanding the issues a company must address, and clues to help find Eco-Advantage.

**WHAT IS CORPORATE SUSTAINABILITY?**

Corporate sustainability indicates new philosophy, as an alternative to the traditional growth and profit-maximization model, under which sustainable development comprising of environmental protection, social justice and equity, and economic development are given more significant focus while recognizing simultaneous growth of the corporate and profitability.

It is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. Corporate sustainability describes business practices built around social and environmental considerations.

Corporate sustainability encompasses strategies and practices that aim to meet the needs of the stakeholders today while seeking to protect, support and enhance the human and natural resources that will be the need of the future. Corporate sustainability leaders achieve long-term shareholder value by gearing their strategies and management to harness the market’s potential for sustainability products and services while at the same time successfully reducing and avoiding sustainability costs and risks.

Thomas Dyllick and Kai Hockerts in ‘Beyond the Business Case for Corporate Sustainability’ define Corporate Sustainability as, "meeting the needs of a firm’s direct and indirect stakeholders (such as shareholders, employees, clients, pressure groups, and communities) without compromising its ability to meet the needs of future stakeholders as well.”
The Australian government defines Corporate Sustainability as "encompassing strategies and practices that aim to meet the needs of the stakeholders today, while seeking to protect, support, and enhance the human and natural resources that will be needed in the future."

Worldwide business communities are recognizing the need to address the environmental and social impacts of their activities. The fundamental business objectives towards creating economic values, clubbed with the environmental and social value addition, evolved the concept of 'triple bottom line' under sustainable development. Corporate Boards are required to address issues, such as environment, social justice and economic efficiency to ensure their long-term existence.

Concern towards social, environmental and economical issues, i.e., covering all the segments of the stakeholders, are now basic and fundamental issues which permit a corporate to operate in the long run sustainably. Following key drivers need to be garnered to ensure sustainability:

- **Internal Capacity Building strength** – In order to convert various risks into competitive advantages.
- **Social impact assessment** – In order to become sensitive to various social factors, like changes in culture and living habits.
- **Repositioning capability** through development and innovation: Crystallisation of all activities to ensure consistent growth.
- **Corporate sustainability** is a business approach creating shareholder value in the long run.

These may be derived by converting risks arising out of economic, environmental and social activities of a corporate into business opportunities keeping in mind the principles of a sustainable development.

As a good corporate citizen, the companies are required to focus on the following key aspects:

- **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.

- **Ethical Corporate Practices**
  In the short run, enterprise can gain through non-ethical practices. However those cannot be sustained in the long run. Society denies accepting such products or services. For example, in Drug and Pharmaceutical industry many products are today obsolete due their side effects which such companies never disclosed to protect their sales volume. Only when they were banned by the WHO or other authorities, they had to stop their production.

- **Worth of the Earth through Environmental Protection**
  Resources which are not ubiquitous and have economic and social value should be preserved for a long-term use and be priced properly after considering environmental and social costs. For example, a power plant should build up its cost model efficiently after taking into account cost of its future raw material sourcing, R&D cost for alternate energy source, cost for proper pollution control measures and so on.

- **Equitable Business Practices**
  Corporates should not indulge themselves in unfair means and should create candid business practices, ensuring healthy competition and fair trade practices.
Corporate Social Responsibility

As a Corporate citizen, every corporate is duty bound to its society wherein it operates and serves. Although there are no hard and fast rules, CSR activities need to be clubbed and integrated into the business model of the company.

Innovate new technology/process/system to achieve eco-efficiency

Innovation is the key to success. Risks and crisis can be eliminated through innovation. Learning and innovative enterprise gets a cutting edge over others. These innovative processes bring sustainability if developments are aimed at satisfying human needs, and ensure quality of life, while progressively reducing ecological impact and resource intensity to a level at least in line with earth’s estimated carrying capacity.

Creating Market for All

Monopoly, unjustified subsidies, prices not reflecting real economic, social environmental cost, etc. are hindrances to the sustainability of a business. Simultaneously, a corporate has to build up its products and services in such a way so as to cater to all segments of customers/consumers. Customer confidence is the essence of corporate success.

Switching over from the Stakeholders Dialogue to holistic Partnership

A business enterprise can advance its activities very positively if it makes all the stakeholders partner in its progress. It not only builds confidence of its stakeholders, but also helps the management to steer the business under a very dynamic and flexible system. This approach offers business, government and other stakeholders of the society to build up an alliance to bring about common solutions to the common concerns faced by all.

Compliance of Statutes

Compliance of statutes, rules and regulations and standards set by various bodies ensure clinical check up of a corporate and confers societal license upon it to the corporate to run and operate its business in the society.

Corporate Sustainability and Corporate Social Responsibility

Although scholars and practitioners often interpret Corporate Sustainability and Corporate Social Responsibility as being nearly synonymous, pointing to similarities and the common domain. The two concepts have different backgrounds and different theoretical paths. According to management science, the notion of Corporate Sustainability can be defined first as the capacity of a firm to create value through the product and services it produces, and to continue operating over the years. Sustainability, in this context, entails the creation of a sustainable competitive advantage.

Corporate Sustainability can be considered as an attempt to adapt the concept of Sustainable Development to the corporate setting, matching the goal of value creation with environmental and social considerations. According to the Dow Jones Sustainability Index, ‘Corporate Sustainability is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. The Journal of Environmental Strategy defines corporate sustainability as ‘the capacity of an enterprise to maintain economic prosperity in the context of environmental responsibility and social stewardship. Accountability, the capability of an organization to continue its activities, indefinitely, has taken due account of its impact on natural, social and human capitals.

Corporate Sustainability includes an attempt to assimilate the environmental and social dimensions into
business operations: processes, products and procedures. In practical terms, the Corporate Sustainability approach leads to a very concrete and pragmatic problem; how to measure performance based on the three dimensions outlined and how natural and social values can be incorporated into corporate accounting.

The evolutionary part of the concept of Corporate Social Responsibility is different from that of the Corporate Sustainability. The first recognized contribution in the literature dates back to Bowen, who stressed the responsibilities of businessmen, 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.

Why is Sustainability an Imperative?

Sustainability is an emerging megatrend and is a measure of good corporate governance. Over the years, environmental issues have steadily encroached on businesses’ capacity to create value for the customers, shareholders, and other stakeholders. Globalized workforces and supply chains have created environmental pressures and attendant business liabilities. The rise of new world powers has intensified competition for natural resources (especially oil) and added a geopolitical dimension to sustainability. “Externalities”, such as carbon dioxide emissions and water use are fast becoming materials—meaning that investors consider them central to a firm’s performance and stakeholders expect companies to share information about them.

These forces are magnified by escalating public and governmental concern about climate change, industrial pollution, food safety, and natural resource depletion, among other issues. Consumers in many countries are seeking out sustainable products and services or leaning on companies to improve the sustainability of traditional ones.

Further fueling this megatrend, thousands of companies are placing strategic bets on innovation in energy
efficiency, renewable power, resource productivity, and pollution control. In the end, it can be concluded that the top management of an organisation can no longer afford to ignore sustainability as a central factor in their companies’ long-term competitiveness.

**Government’s Role in improving Sustainability Reporting**

Governments are interceding with unprecedented levels of new regulations, like SEBI mandated Business Responsibility Reporting in India for top listed companies besides the voluntary reporting for others. Integrated Reporting in South Africa and many other jurisdictions are placing similar requirement on companies to report about the sustainability aspects in addition to financial information.

In 2011, Ministry of Corporate Affairs (MCA), Govt. of India issued the first voluntary reporting framework for reporting on Business Responsibility in the form of ‘National Voluntary Guidelines (NVG) on Social, Environmental and Economic Responsibilities of Business’. SEBI considering the framework given under the NVG guidelines, inserted clause 55 to the listing agreement to give mandate to top 100 listed companies to adopt the Business Responsibility Framework. The other listed companies are encouraged to adopt the Business Responsibility Reporting voluntarily. The similar regulators initiatives are required in other jurisdiction also to encourage the companies to adopt the Reporting on Sustainability aspects.

Over the past 10 years, environmental issues have steadily encroached on businesses’ capacity to create value for customers.

**KYOSEI**

A concise definition of this word would be “living and working together for the common good,” but for some, the definition is broader: “All people, regardless of race, religion or culture, harmoniously living and working together into the future.” Kyosei is a Japanese technique meaning “a spirit of cooperation”.

Kyosei establishes harmonious relations among the company and -

- Customers
- Suppliers
- Competitors
- Governments
- Natural Environment

Kyosei philosophy reflects a confluence of social, environmental, technological and political solutions. It believes that peace, prosperity and social and environmental improvement come through positive action.

It works in five stages

- First is economic survival of the company
- Second is cooperating with labour
- Third is cooperating outside the company
- Fourth is global activism, and
- Fifth is making the government/s a Kyosei partner

In the first stage of kyosei, a company must work to secure a predictable stream of profits and to establish
strong market positions. At this stage corporate is at the stage of evolution and it is concerned with profit making and its economic survival. Stakeholder’s benefits are not a major concern area.

From this foundation, it moves on to the second stage, in which managers and workers resolve to cooperate with one another, recognizing that both groups are vital to the company’s success. Managers and workers unite in working for the prosperity of the corporation and both have a share in the profits. Labor disputes get resolved at this stage, but community development and environmental protection measures are yet to be undertaken by the company.

A small beginning is made by creating a cooperative spirit among employees. Many Japanese companies have eliminated the distinction between salaried and hourly workers. They have done away with the rule that the workers had to use different cafeterias and rest rooms.

In the third stage, this sense of cooperation is extended beyond the company to encompass customers, suppliers, community groups, and even competitors. At this stage company assumes local social responsibilities. Companies respect the interests of their own stakeholders, customers, staff, shareholders, suppliers, competitors and the local community. Suppliers are provided with technical support and, in turn, deliver high quality materials on time. Competitors are invited for partnership agreements and joint ventures, which results in higher profits for both parties. Forming Kyosei partnership for the common good is very different from forming a cartel and fixing prices. Community groups become partners in solving local problems.

Partnership with Competitors’ other than forming cartels and price fixing is reflected in the activities that they do for common good. For example, ATM facility of one bank, according to the central bank guidelines can be used by customers of the competitor’s bank. This benefits the competitors and adds value to their customer base.

At the fourth stage, a company takes the cooperative spirit beyond national boundaries and addresses some of the global imbalances. At this stage company assumes global social responsibilities. It begins to take care of all its direct stakeholders, including its local community and beyond. Thus it strives to fulfill its corporate obligations on a global scale. A company can help reduce trade friction by building production facilities and training local scientists and engineers in other countries. Thereby, improving the standard of living of the people in poor countries by exposing them to new technologies.

Its social responsibilities transcend national boundaries. In the fifth stage, which companies rarely achieve, a company urges its national government to work towards rectifying global imbalances. At the global level Kyosei will address --

- Trade imbalances
- Income imbalances
- Environmental imbalances

by advocating political, economic and educational reform.

Kyosei philosophy banks upon the theory of corporate governance that makes governance function look outside in

- Governance leadership will pull and push executive leadership towards satisfaction of all the stakeholders
- Conflicts and tension will be replaced by creative living and working together
- Spirit of happy cooperation is made all-pervasive
Strong relationships are the sine qua non of the Kyosei framework of responsibility. Togetherness and unity of life objectives are the idealist nature of Kyosei. Japanese companies like Canon strive hard to make the ideal a reality.

THE CORPORATE PHILOSOPHY OF CANON IS KYOSEI.

A concise definition of the word would be "Living and working together for the common good," but Canon’s definition is broader: “All people, regardless of race, religion or culture, harmoniously living and working together into the future.” Unfortunately, the presence of imbalances in the world in such areas as trade, income levels and the environment hinders the achievement of kyosei.

Addressing these imbalances is an ongoing mission, and Canon is doing its part by actively pursuing kyosei. Truly global companies must foster good relations, not only with their customers and the communities in which they operate, but also with nations and the environment. They must also bear the responsibility for the impact of their activities on society. For this reason, Canon’s goal is to contribute to global prosperity and the well-being of mankind, which will lead to continuing growth and bring the world closer to achieving kyosei.

TRIPLE BOTTOM LINE (TBL)

In 1999 Elkington developed the concept of the Triple Bottom Line which proposed that business goals are inseparable from the society and environment within which they operate. Whilst a short-term economic gain could be chased, a failure to account for the social and environmental impacts would make those business practices unsustainable. While each of the three pillars of sustainability, i.e., economic, social and environment is independently crucial and urgent in the short-run, but in order to reach the goal of sustainability in the long-run, the three pillars must be satisfied simultaneously. These three dimensions are deeply inter-connected and they influence and support each other.

Three key aspects of sustainable Development


The Triple Bottom Line is made up of "Social, Economic and Environmental" aspect and indicated is by the "People, Planet, Profit" phrase.

"People" means Human Capital. It implies that fair and beneficial business practices towards labour and the community and region in which a corporation conducts its business would create long-term value. Wellbeing
of a corporate, its labour and other stakeholder interests are interdependent. For example, policy retraining use of child labor, fair pay to workforce, health and safety at work place, tolerable working hours, etc., and would not otherwise exploit a community or its labor force.

The second aspect of TBL is "Planet" - the Natural Capital. It refers to sustainable environmental practices. A company which decides to follow TBL always keep in mind that it does no harm to nature or creates negative environmental impact.

Reduction of ecological footprint by efficient energy consumption and use of non-renewable assets as well as by reduction of manufacturing waste are the core components of TBL.

A TBL company, as a corporate policy, debars itself from manufacturing harmful or destructive products, such as weapons, and those toxic chemicals etc. that are injurious to society as well as nature. Even if they are involved in such activities they ensure to protect nature as well as human society from its hazardous process and the products.

Simultaneously, a TBL company avoids ecologically destructive practices, such as overfishing or other endangering depletions of resources.

The third aspect of triple bottom line is profit. The concept of profit for TBL company is somehow more wider in all perspective. It is the reflection of economic impact an organization has on its business activities and that too after meeting all costs that would protect society and environment. It somehow indicates real value addition a corporate makes through its various activities.

Worldwide many corporates are now adopting Triple Bottom Line under vision and mission and practicing the same through aligning their corporate polices in that direction.

Many countries worldwide are now contemplating how to integrate this triple bottom line under their legal system.

CONCLUSION

Leading sustainability companies display high levels of competence in addressing global and industrial challenges in a variety of areas:

**Strategy:** Integrating long-term economic, environmental and social aspects in their business strategies while maintaining global competitiveness and brand reputation.

**Financial:** Meeting the shareholders' demands for sound financial returns, long-term economic growth, open communication and transparent financial accounting.

**Customer & Product:** Fostering loyalty by investing in customer relationship management, product and service innovation that focuses on technologies and systems, which use financial, natural and social resources in an efficient, effective and economic manner over the long-term.

**Governance and the Stakeholder:** Setting the highest standards of corporate governance and stakeholders' engagement, including corporate codes of conduct and public reporting.

**Human Capital:** Managing human resources to maintain workforce capabilities and employee satisfaction through best-in-class organisational learning and knowledge, management practices and appropriate remuneration and benefit programs.

The emergence of corporate responsibility, from being a niche interest of environmentalist and pressure groups to one public. Concern, has in part, stemmed from the realization that corporate governance and social and environmental performances are important elements of sustained financial profitability.
LESSON ROUND-UP

- One of the fundamental characteristics of a corporate is perpetuity. In the eyes of law, it is treated as a separate legal entity which can hold assets and bear liabilities, can sue and be sued.

- The word sustainable is derived from sustain or sustained. The synonyms of the word sustained according to the Collins Thesaurus include perpetual, prolonged, steady.

- 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 changes are all in harmony, and enhance both current and future potential to meet human needs and aspirations.

- WCED recognized that the achievement of sustainable development could not be simply left to the government regulators and policy makers. It recognized that industry has a significant role to play in it.

- Four fundamental Principle of Sustainable Development are:- Principle of Intergenerational equity; Principle of sustainable use; Principle of equitable use or intergenerational equity; Principle of integration.

- 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. Corporate sustainability describes business practices built around social and environmental considerations.

- Key drivers need to be garnered to ensure sustainability - Internal Capacity Building strength; Social impact assessment; Repositioning capability; Corporate sustainability.

- Kyosei philosophy reflects a confluence of social, environmental, technological and political solutions. It works in five stages-- First is economic survival of the company. Second is cooperating with the labour. Third is cooperating outside the company. Fourth is global activism, and the fifth is making the government/s a Kyosei partner.

- In 1999 Elkington developed the concept of the Triple Bottom Line which proposed that business goals were inseparable from the societies and environment within which they operate. Whilst short-term economic gain could be chased, a failure to account for social and environmental impacts would make those business practices unsustainable.

- The emergence of corporate responsibility from being a niche interest of environmentalists and pressure groups to public concern, has in part, stemmed from the realization that corporate governance and social and environmental performance are important elements of sustained financial profitability.

SELF-TEST QUESTIONS

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

1. Explain in detail the meaning of sustainability and the role business plays in sustainable development.

2. What are the areas that companies should focus on as a part of its corporate responsibility?

3. What do you understand by Japanese technique of Kyosei?

4. Why is sustainability an imperative?
Lesson 15
Corporate Sustainability Reporting Frameworks

LESSON OUTLINE

- Sustainability Reporting
- Benefits of Sustainability Reporting
- GRI - Sustainability Reporting Framework
- GRI - Sustainability Reporting Guidelines
- UN Global Compacts’ 10 Principles, 2000
- UN Global Compact’s Communication on Progress
- UN Principles for Responsible Investment
- Sustainability Indices
- Sustainability Reporting Framework in India
- Challenges in Mainstreaming Sustainability Reporting
- Integrated Reporting
- Integrated Reporting Framework
- Relation between Integrated Reporting and Sustainability Reporting
- Lesson Round-up
- Self Test Questions

LEARNING OBJECTIVES

Companies are the main contributors to economic, social and environmental well-being. Corporate activities are vital in the present and will have serious bearing on the future. Therefore, corporate sustainability is imperative for the long-term sustainable development of the economy and society. In this study, we will understand the meaning of sustainability reporting, its framework and guidelines. The study also covers some contemporary developments like integrated reporting.
SUSTAINABILITY REPORTING

The concept of sustainability reporting is of recent origin. Conventionally financial accounting was the tool that aided management control. Then, management accounting has emerged separately with focus on generating information for management planning, control and decision-making. In the recent years, with emphasis being placed on the ways in which companies match their resources to the needs of the marketplace, it has given rise to the concept of corporate performance management and measurement. The new approach is an integrated one seeking to link strategic management, management accounting and reporting. The reporting contemplated here covers the whole information communication process comprising internal and external stakeholders. Sustainability reporting is a part of the new approach.

Sustainability reporting is a process for publicly disclosing an organization’s economic, environmental, and social performance. Many companies find that financial reporting alone no longer satisfies the needs of shareholders, customers, communities and other stakeholders for information about overall organizational performance. Through sustainability reporting, organizations report on progress against performance goals not only for economic achievements, but for environmental protection and social well-being.

John Elkington has coined the term ‘triple bottom line’ to describe social, environmental and financial accounting. A sustainability report comprises information on how a company, proactively and beyond regulations, acts responsibly towards the environment around it and works towards equitable and fair business practices and brings to life products and services with lower impacts on the natural environment. Such a report describes how a company has implemented a greener supply chain, has engaged with local communities, is helping tackle climate-change issues, or is “innovating for the poor”. Best-in-class reports mention where raw material labour are sourced from, and openly discuss sustainability issues at hand (e.g. diversity in the workforce, overall environmental footprint, safety performance, labour conditions in the supply-chain), along with the associated “remediation steps”. Some of the best reporting organisations benchmark their sustainability performance against global peers.

A sustainability report is a report published by a company or organization about the economic, environmental and social impacts caused by its everyday activities. A sustainability report also presents the organization’s values and governance model, and demonstrates the link between its strategy and its commitment to a sustainable global economy.

Sustainability reporting can be considered as synonymous with other terms for non-financial reporting; triple bottom line reporting, corporate social responsibility (CSR) reporting, and more. It is also an intrinsic element of integrated reporting; a more recent development that combines the analysis of financial and non-financial performance.

Benefits of sustainability reporting

Sustainability reporting can help organizations to measure, understand and communicate their economic, environmental, social and governance performance, and then set goals, and manage change more effectively. A sustainability report is the key platform for communicating sustainability performance and impacts – whether positive or negative.

- Internal benefits of sustainability reporting for companies and organizations can include:
  - Increased understanding of risks and opportunities
- Emphasizing the link between financial and non-financial performance
• Influencing long term management strategy and policy, and business plans
• Streamlining processes, reducing costs and improving efficiency
• Benchmarking and assessing sustainability performance with respect to laws, norms, codes, performance standards, and voluntary initiatives
• Avoiding being implicated in publicized environmental, social and governance failures
• Comparing performance internally, and between organizations and sectors

External benefits of sustainability reporting can include:
• Mitigating – or reversing – negative environmental, social and governance impacts
• Improving reputation and brand loyalty
• Enabling external stakeholders to understand the organization’s true value, and tangible and intangible assets
• Demonstrating how the organization influences, and is influenced by, expectations about sustainable development

Building and maintaining trust in businesses and governments is fundamental to achieving a sustainable economy and world. Every day, decisions are made by businesses and governments which have direct impacts on their stakeholders, such as financial institutions, labor organizations, civil society and citizens, and the level of trust they have with them. These decisions are rarely based on financial information alone. They are based on an assessment of risk and opportunity using information on a wide variety of immediate and future issues.

The value of the sustainability reporting process is that it ensures organizations consider their impacts on these sustainability issues, and enables them to be transparent about the risks and opportunities they face. Stakeholders also play a crucial role in identifying these risks and opportunities for organizations, particularly those that are non-financial. This increased transparency leads to better decision making, which helps build and maintain trust in businesses and governments. 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. There is a growing trend for large companies to request sustainability information from their suppliers as part of their evaluation criteria. The US retailer Walmart announced an initiative for a worldwide sustainable product index in July 2009. This initiative would create a database across leading retailers to facilitate comparisons of sustainability performance of leading products.

- **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. So, too, are CEOs, who consider sound social and environmental policies a critical element of corporate success. Companies report that integrated reporting drives them to re-examine processes with an eye towards resource allocation, waste elimination and efficiency improvements. Balancing financial growth, corporate responsibility, shareholder returns and stakeholder demands also leads to an evaluation of the trade-off between short term gains and long-term profits.

- **Investors:** Increasingly, investors want to know that companies they have targeted have responsible, sustainable, long-term business approaches. Institutional investors and stock exchange CEOs, for example, have moved to request increased sustainability reporting from listed companies, and environmental, social and corporate governance indices have been established such as the Dow Jones Sustainability Index.

### GLOBAL REPORTING INITIATIVE - SUSTAINABILITY REPORTING FRAMEWORK

As for financial reporting, companies follow a generally accepted reporting framework; Global Reporting Initiative (GRI) has developed a generally accepted framework to simplify report preparation and assessment, helping both reporters and report users gain greater value from sustainability reporting.

Global Reporting Initiative (GRI) is an initiative at the global level to standardize non-financial Reporting (NFR), which the institutions adopt and has become the standard internationally.

GRI is a long-term, multi-stakeholder, international process whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines. The aim of the Guidelines is to assist reporting organizations and their stakeholders in articulating and understanding contributions of the reporting organizations to sustainable development.

GRI is a permanent, independent organization, with a distinguished Board of Directors, and global headquarters in Amsterdam, Netherland. The Board has fiduciary, financial and legal, and overall strategic responsibilities for GRI. Broadly representative advisory groups on policy (the stakeholder council) and technical issue (the Technical Advisory Council) ensure that the GRI’s core values of inclusiveness and transparency are sustained. Organizational stakeholders support GRI’s mission, contribute to the annual budget and elect the stakeholder council.

The Global Reporting Initiative (GRI) is a large multi-stakeholder network of thousands of experts, in dozens of countries worldwide, who participate in GRI’s working groups and governance bodies, use the GRI Guidelines to report, access information in GRI-based reports, or contribute to develop the Reporting Framework in other ways – both formally and informally.
The GRI Sustainability Reporting Framework is made up of the Sustainability Reporting Guidelines, Sector supplements and Indicator Protocols. Together these are known as the Sustainability Reporting Framework. The GRI Reporting Framework is intended to serve as a generally accepted framework for reporting on an organization's economic, environmental, and social performance. It is designed for use by organizations of any size, sector, or location. It takes into account the practical considerations faced by a diverse range of organizations – from small enterprises to those with extensive and geographically dispersed operations.

The Sustainability Reporting Guidelines are the core element of the Reporting Framework. They outline content that is broadly relevant to all organizations regardless of size, sector or location. The Sustainability Reporting Guidelines developed by the Global Reporting Initiative, is a significant system that integrates sustainability issues in to a frame of reporting.

GLOBAL REPORTING INITIATIVE - SUSTAINABILITY REPORTING GUIDELINES

An ever-increasing number of companies and other organizations want to make their operations sustainable. Moreover, expectations that long-term profitability should go hand-in-hand with social justice and protecting the environment are gaining ground. These expectations are only set to increase and intensify as the need to move to a truly sustainable economy is understood by companies' and organizations’ financiers, customers and other stakeholders. Sustainability reporting helps organizations to set goals, measure performance, and manage change in order to make their operations more sustainable.

In this context, the Global Reporting Initiative (GRI) launched the fourth generation of its sustainability reporting guidelines: the GRI G4 Sustainability Guidelines (the Guidelines) in 2013. The aim of G4, is to help reporters prepare sustainability reports that matter, contain valuable information about the organization’s most critical sustainability-related issues, and make such sustainability reporting standard practice.

G4 is applicable to all organizations, large and small, across the world. The Guidelines are now presented in two parts to facilitate the identification of reporting requirements and related guidance. It consist of following two parts-

- **Part 1-** Reporting Principles and Standard Disclosures: It contains the reporting principles and standard disclosures and also sets out the criteria to be applied by an organization to prepare its sustainability report in accordance with the Guidelines.

- **Part 2 -** Implementation Manual: It contains reporting and interpretative guidance that an organization should consult when preparing its sustainability report.

The Guidelines are designed to align and harmonize as much as possible with other internationally recognized standards. The Guidelines provide links with the United Nations Global Compact's Ten Principles, 2000; the OECD's Guidelines for Multinational Enterprises, 2011; and the UN's Guiding Principles on Business and Human Rights, 2011.

**Reporting Principles**

The Reporting Principles are fundamental to achieving transparency in sustainability reporting and therefore should be applied by all organizations when preparing a sustainability report. The Implementation Manual outlines the required process to be followed by an organization in making decisions consistent with the Reporting Principles.

The Principles are divided into two groups:

1. **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.

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<th>Principle</th>
<th>Description</th>
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<td>Stakeholder Inclusiveness</td>
<td>The organization should identify its stakeholders, and explain how it has responded to their reasonable expectations and interests.</td>
<td>Stakeholders can include those who are invested in the organization as well as those who have other relationships to the organization. The reasonable expectations and interests of stakeholders are a key reference point for many decisions in the preparation of the report.</td>
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<td>Sustainability Context</td>
<td>The report should present the organization’s performance in the wider context of sustainability.</td>
<td>Information on performance should be placed in context. The underlying question of sustainability reporting is how an organization contributes, or aims to contribute in the future, to the improvement or deterioration of economic, environmental and social conditions, developments, and trends at the local, regional or global level. Reporting only on trends in individual performance (or the efficiency of the organization) fails to respond to this underlying question. Reports should therefore seek to present performance in relation to broader concepts of sustainability. This involves discussing the performance of the organization in the context of the limits and demands placed on environmental or social resources at the sector, local, regional, or global level.</td>
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<td>Materiality Principle</td>
<td>The report should cover Aspects that: Ŷ Reflect the organization’s significant economic, environmental and social impacts; or Ŷ Substantively influence the assessments and decisions of stakeholders</td>
<td>Organizations are faced with a wide range of topics on which they could report. Relevant topics are those that may reasonably be considered important for reflecting the organization’s economic, environmental and</td>
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social impacts, or influencing the decisions of stakeholders, and, therefore, potentially merit inclusion in the report. Materiality is the threshold at which Aspects become sufficiently important that they should be reported.

**Completeness**

The report should include coverage of material Aspects and their Boundaries, sufficient to reflect significant economic, environmental and social impacts, and to enable stakeholders to assess the organization’s performance in the reporting period.

Completeness primarily encompasses the dimensions of scope, boundary, and time. The concept of completeness may also be used to refer to practices in information collection and whether the presentation of information is reasonable and appropriate.

**(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.

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<td><strong>Balance</strong></td>
<td>The report should reflect positive and negative aspects of the organization’s performance to enable a reasoned assessment of overall performance.</td>
<td>The overall presentation of the report’s content should provide an unbiased picture of the organization’s performance. The report should avoid selections, omissions, or presentation formats that are reasonably likely to unduly or inappropriately influence a decision or judgement by the report reader.</td>
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<td><strong>Comparability</strong></td>
<td>The organization should select, compile and report information consistently.</td>
<td>The reported information should be presented in a manner that enables stakeholders to analyze changes in the organization’s performance over time, and that could support analysis relative to other organizations. Comparability is necessary for evaluating performance. Stakeholders using the report should be able to compare information reported on</td>
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<td><strong>Accuracy</strong></td>
<td>The reported information should be sufficiently accurate and detailed for stakeholders to assess the organization’s performance.</td>
<td>Responses to economic, environmental and social DMA and Indicators can be expressed in many different ways, ranging from qualitative responses to detailed quantitative measurements. The characteristics that determine accuracy vary according to the nature of the information and the user of the information.</td>
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<td><strong>Timeliness</strong></td>
<td>The organization should report on a regular schedule so that information is available in time for stakeholders to make informed decisions.</td>
<td>The usefulness of information is closely tied to whether the timing of its disclosure to stakeholders enables them to effectively integrate it into their decision-making. The timing of release refers both to the regularity of reporting as well as its proximity to the actual events described in the report.</td>
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<td><strong>Clarity</strong></td>
<td>The organization should make information available in a manner that is understandable and accessible to stakeholders using the report.</td>
<td>Information should be presented in a manner that is comprehensible to stakeholders who have a reasonable understanding of the organization and its activities.</td>
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<td><strong>Reliability</strong></td>
<td>The organization should gather, record, compile, analyze and disclose information and processes used in the preparation of a report in a way that they can be subject to examination and that establishes the quality and materiality of the information.</td>
<td>Stakeholders should have confidence that a report can be checked to establish the veracity of its contents and the extent to which it has appropriately applied Reporting Principles.</td>
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Standard Disclosures

There are two different types of Standard Disclosures:

**General Standard Disclosures:** The General Standard Disclosures are applicable to all organizations preparing sustainability reports. The General Standard Disclosures are divided into seven parts:

- Strategy and Analysis
- Organizational Profile
- Identified Material Aspects and Boundaries
- Stakeholder Engagement
- Report Profile
- Governance
- Ethics and Integrity

**Specific Standard Disclosures:** The Guidelines organize Specific Standard Disclosures into three Categories - Economic, Environmental and Social. The economic dimension of sustainability concerns the organization’s impacts on the economic conditions of its stakeholders and on economic systems at local, national, and global levels. The Social Category is further divided into four sub-Categories, which are Labor Practices and Decent Work, Human Rights, Society and Product Responsibility.

The organization’s sustainability report presents information relating to material Aspects, that is, those Aspects for which impacts are identified as material by the organization. Material Aspects are those that reflect the organization’s significant economic, environmental and social impacts; or that substantially influence the assessments and decisions of stakeholders. The Reporting Principles for Defining Report Content have been designed to assist organizations in identifying material Aspects and their Boundaries and to indicate where their impacts may be identified as material. It does not focus on the financial condition of the organization.

The information reported for each identified material Aspect can be disclosed as

- Disclosures on Management Approach
- Indicators

Details of full disclosures are available in the website of GRI - https://www.globalreporting.org/resourcelibrary/GRIG4-Part1-Reporting-Principles-and-Standard-Disclosures.pdf which student may refer.

**UNITED NATIONS GLOBAL COMPACT’S TEN PRINCIPLES, 2000**

Corporate sustainability starts with a company’s value system and a principled approach to doing business. This means operating in ways that, at a minimum, meet fundamental responsibilities in the areas of human rights, labour, environment and anti-corruption. Responsible businesses enact the same values and principles wherever they have a presence, and know that good practices in one area do not offset harm in another.

The UN Global Compact is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption. By incorporating the Global Compact principles into strategies, policies and
procedures, and establishing a culture of integrity, companies are not only upholding their basic responsibilities to people and planet, but also setting the stage for long-term success. The UN Global Compact's Ten Principles are derived from: the Universal Declaration of Human Rights, the International Labour Organization’s Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

**Ten Principles**

- Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
- Principle 2: make sure that they are not complicit in human rights abuses.
- Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
- Principle 4: the elimination of all forms of forced and compulsory labour;
- Principle 5: the effective abolition of child labour; and
- Principle 6: the elimination of discrimination in respect of employment and occupation.
- Principle 7: Businesses should support a precautionary approach to environmental challenges;
- Principle 8: undertake initiatives to promote greater environmental responsibility; and
- Principle 9: encourage the development and diffusion of environmentally friendly technologies.
- Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

**UNITED NATIONS GLOBAL COMPACT’S COMMUNICATION ON PROGRESS**

UN Global Compact incorporates a transparency and accountability policy known as the Communication on Progress (COP). The Communication on Progress (COP) is an annual disclosure to stakeholders on progress made in implementing the ten principles of the UN Global Compact in the areas of human rights, labour, environment and anti-corruption, and in supporting broader UN development goals. The COP is posted on the Global Compact website by business participants. Failure to issue a COP will change a participant’s status to non-communicating and can eventually lead to the expulsion of the participant.

**Purpose:**

- The COP helps drive continuous sustainability performance improvement within the company. The library of COPs at the UN Global Compact website represents the largest repository of corporate practices in sustainability.
- The COP provides investors with sustainability performance information of companies, thus allowing for a more effective integration of environmental, social and governance (ESG) considerations in their investments and resulting in a more effective allocation of capital.
- The COP is an important demonstration of a company’s commitment to transparency and accountability and it serves as an effective tool for multi-stakeholder dialogue.

Joining the Global Compact is a widely visible commitment to the ten principles. A company that signs-on to the Global Compact specifically commits itself to:

- set in motion changes to business operations so that the Global Compact and its principles become part of management, strategy, culture, and day-to-day operations;
— publish in its annual report or similar public corporate report (e.g. sustainability report) a description of the ways in which it is supporting the Global Compact and its principles (Communication on Progress),
— publicly advocate the Global Compact and its principles via communications vehicles such as press releases, speeches, etc.

Benefits of participation include:

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<td>Global and local opportunities to dialogue and collaborate with other businesses, NGOs, labour, and governments on critical issues</td>
<td>Increased legitimacy and license to operate, particularly in the developing world, because business practices are based on universal values</td>
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<td>Exchange of experiences and good practices inspiring practical solutions and strategies to challenging problems</td>
<td>Improved reputation and increasing brand value to consumers and investors – specifically in the context of changing societal expectations</td>
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<td>Finding an entry-point through which companies can access the UN's broad knowledge of development issues</td>
<td>Increased employee morale and productivity, and attracting and retaining the highest qualified employees</td>
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<td>Leveraging the UN's global reach and convening power with governments, business, civil society and other stakeholders</td>
<td>Improved operational efficiency, for instance through better use of raw materials and waste management</td>
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<td>Ensuring a company’s accountability and transparency through a public communication on progress</td>
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Ideally, COPs should be integrated into a participant’s existing communication with stakeholders, such as an annual or sustainability report. However, in case a participant does not publish such reports, a COP can be a stand-alone report that is made available for stakeholders through other public communication channels (e.g. websites, newsletters, intranets, company notice boards, included with payroll, etc.). COPs should be issued in the company's working language and, if the company determines a need, in additional languages.

Participants are asked to supply a URL link to their COP and to upload the COP itself (as a PDF, Powerpoint, or word document) to the Global Compact website in order to meet the COP submission requirement.

While there is no strict format for a COP, in order to be considered complete, it must contain:
— a statement of continued support for the Global Compact in the opening letter, statement or message from the company’s top executive;
— description of practical actions that participants have taken to implement the Global Compact principles since their last COP (or since they joined the Global Compact);
— a measurement of outcomes or expected outcomes using, as much as possible, indicators or metrics such as, for example, the Global Reporting Initiative Guidelines.

**Initial COP submission** - New participants must submit their first COP one year after joining the initiative.
Subsequent COP submissions - Existing participants are required to submit their COPs one year after the last submission. For example, if the last submission took place on 1 March 2013, the next COP will be due on 1 March 2014.

If a company fails to meet a COP submission deadline, it will be marked as “non-communicating”. Companies that have been non-communicating for longer than 12 months will be expelled from the Global Compact.

Grace period – There are two options to request a deadline modification:

- Grace Period Letter (grants an additional 90 days); or Adjustment Request (one-time only deferral of up to 11 months to adjust the reporting cycle)

A Grace Period Letter extends the deadline by 90 days. Unlike the Adjustment Request, it can be used more than once, as long as it is not used consecutively. A Grace Period letter explains that the company is requesting additional time to submit its COP and explains the reason behind the request. An Adjustment Request explains what the company’s standard reporting cycles are, in order to align the COP submission deadline with them.

UN-PRINCIPLES FOR RESPONSIBLE INVESTMENT (PRI)

The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. The Principles were launched by the UN Secretary-General Kofi Annan at the New York Stock Exchange in April 2006. The Principles were designed to be applied by all investors, with a special focus on fiduciary institutions with long-term perspectives.

The PRI Initiative aims to help investors integrate the consideration of environmental, social and governance (ESG) issues into investment decision-making and ownership practices across all asset classes and regions, and in so doing, help contribute to the creation of a sustainable financial system.

PRI signatories are also part of a global network, with opportunities to pool their resources and influence to engage with companies on ESG issues, lowering costs for signatories to undertake stewardship activities. The Initiative also supports investors to work together to address systemic problems that, if remedied, may lead to less volatile, accountable and sustainable financial markets that reward long-term responsible investment.

Following are the Six PRI Principles for Institutional Investors:

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

Possible actions:

- Address ESG issues in investment policy statements
- Support development of ESG-related tools, metrics, and analyses
- Assess the capabilities of internal investment managers to incorporate ESG issues
- Assess the capabilities of external investment managers to incorporate ESG issues
- Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis
• Encourage academic and other research on this theme
• Advocate ESG training for investment professionals

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

Possible actions:
• Develop and disclose an active ownership policy consistent with the Principles
• Exercise voting rights or monitor compliance with voting policy (if outsourced)
• Develop an engagement capability (either directly or through outsourcing)
• Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights)
• File shareholder resolutions consistent with long-term ESG considerations
• Engage with companies on ESG issues
• Participate in collaborative engagement initiatives
• Ask investment managers to undertake and report on ESG-related engagement

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

Possible actions:
• Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative)
• Ask for ESG issues to be integrated within annual financial reports
• Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact)
• Support shareholder initiatives and resolutions promoting ESG disclosure

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

Possible actions:
• Include Principles-related requirements in requests for proposals (RFPs)
• Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate)
• Communicate ESG expectations to investment service providers
• Revisit relationships with service providers that fail to meet ESG expectations
• Support the development of tools for benchmarking ESG integration
• Support regulatory or policy developments that enable implementation of the Principles
**Principle 5:** We will work together to enhance our effectiveness in implementing the Principles.

Possible actions:

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning
- Collectively address relevant emerging issues
- Develop or support appropriate collaborative initiatives

**Principle 6:** We will each report on our activities and progress towards implementing the Principles.

Possible actions:

- Disclose how ESG issues are integrated within investment practices
- Disclose active ownership activities (voting, engagement, and/or policy dialogue)
- Disclose what is required from service providers in relation to the Principles
- Communicate with beneficiaries about ESG issues and the Principles
- Report on progress and/or achievements relating to the Principles using a ‘Comply or Explain’* approach
- Seek to determine the impact of the Principles
- Make use of reporting to raise awareness among a broader group of stakeholders

In signing the Principles, Institutional Investors publicly commit to adopt and implement them, where consistent with their fiduciary responsibilities and commit to evaluate the effectiveness and improve the content of the Principles over time. They also encourage other investors to adopt the Principles.

### SUSTAINABILITY INDICES

(A) **DOW-JONES SUSTAINABILITY INDEX**

The Dow Jones Sustainability Indices are the first global indices tracking the financial performance of the leading sustainability-driven companies worldwide, it was launched in 1999.

The Dow Jones Sustainability World Index (DJSI World) comprises more than 300 companies that represent the top 10% of the leading sustainability companies out of the biggest 2500 companies in the Dow Jones World Index.

In addition to the composite DJSI World, there are six specialized subset indexes excluding alcohol, ex gambling, ex tobacco, ex armaments & firearms, ex alcohol, tobacco, gambling, armaments & firearms indexes, and ex alcohol, tobacco, gambling armaments & firearms, and adult entertainment.

(B) **ENVIRONMENT, SOCIAL, GOVERNANCE (ESG) INDEX**

ESG describes the environmental, social and corporate governance issues that investors are considering in the context of corporate behaviour. Integration of ESG refers to the active investment management processes that include an analysis of environmental, social, and corporate governance risks and opportunities and sustainability aspects of company performance evaluation.

The ESG index employs a unique and innovative methodology that quantifies a company's ESG practices and translates them into a scoring system which is then used to rank each company against its peers in the
market. Its quantitative scoring system offers investors complete transparency on Environmental, Social & governance issues of a company.

**Key Performance Indicators:**

- **Environment** - Energy use and efficiency, Greenhouse gas emissions, Water use, Use of ecosystem services – impact & dependence and Innovation in environment friendly products and services.
- **Social** - Employees, Poverty and community impact and Supply chain management
- **Governance** - Codes of conduct and business principles, accountability, transparency and disclosure and Implementation – quality and consistency.

(C) STANDARD & POOR’S ESG INDIA INDEX

Standard & Poor’s ESG India index provides investors with exposure to a liquid and tradable index of 50 of the best performing stocks in the Indian market as measured by environmental, social, and governance parameters. The index employs a unique and innovative methodology that quantifies a company’s ESG practices and translates them into a scoring system which is then used to rank each company against their peers in the Indian market. Its quantitative scoring system offers investors complete transparency.

The creation of the index involves a two step process, the first of which uses a multi-layered approach to determine an ‘ESG’ score for each company. The second step determines the weighting of the index by score. Index constituents are derived from the top 500 Indian companies by total market capitalizations that are listed on National Stock Exchange of India Ltd. (NSE). These stocks are then subjected to a screening process which yields a score based on a company’s ESG disclosure practices in the public domain.

**SUSTAINABILITY REPORTING FRAMEWORK IN INDIA**

The Ministry of Corporate Affairs (MCA) recommends sustainability reporting in India. Considering the importance of sustainability in businesses, MCA launched Corporate Social Responsibility Voluntary Guidelines in 2009. This voluntary CSR Policy addresses six core elements – Care for all Stakeholders, Ethical functioning, Respect for Workers’ Rights and Welfare, Respect for Human Rights, Respect for Environment and Activities for Social and Inclusive Development. To take this further, in 2011 MCA issued ‘National Voluntary Guidelines on Social, Environmental and Economical Responsibilities of Business’ which encourages reporting on environment, social and governance issues.

In line with the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business and considering the larger interest of public disclosure regarding steps taken by listed entities from an Environmental, Social and Governance (“ESG”) perspective, SEBI decided to mandate inclusion of Business Responsibility Reports (“BR reports”) as part of the Annual Reports for listed entities.

SEBI in its (Listing Obligations and Disclosure Requirements) Regulations, 2015 has required that the annual report of a listed entity shall contain BRR describing initiative taken by them from an environmental, social and governance perspective in the prescribed format [Regulation 34(2)(f)].

Business Responsibility Report is a disclosure of adoption of responsible business practices by a listed company to all its stakeholders. This is important considering the fact that these companies have accessed funds from the public, have an element of public interest involved, and are obligated to make exhaustive disclosures on a regular basis.

SEBI has prescribed a format for ‘Business Responsibility Report’. It contains a standardized format for companies to report the actions undertaken by them towards adoption of responsible business practices.
Business Responsibility Report has been designed to provide basic information about the company, information related to its performance and processes, and information on principles and core elements of the Business Responsibility Reporting. The prescribed format of a Business Responsibility Report also provides a set of generic reasons which the company can use for explaining their inability to adopt the business responsibility policy. Further, Business Responsibility Report has been designed as a tool to help companies understand the principles and core elements of responsible business practices and start implementing improvements which reflect their adoption in the manner the company undertakes its business.

The BRR framework is divided into five sections:

(a) **Section A**: General Information about the Organisation – Industry Sector, Products & Services, Markets, other general information

(b) **Section B**: Financial Details of the Organisation – Paid up capital, Turnover, Profits, CSR (Corporate Social Responsibility) spend.

(c) **Section C**: Other Details – BR initiatives at Subsidiaries and Supply-chain Partners

(d) **Section D**: BR Information – Structure, Governance & Policies for Business Responsibility

(e) **Section E**: Principle-wise Performance – Indicators to assess performance on the 9 Business Responsibility principles as envisaged by the National Voluntary Guidelines (NVGs)

**Business Responsibility Report – Suggested Framework**

**Section A: General Information about the Company**

1. Corporate Identity Number (CIN) of the Company
2. Name of the Company
3. Registered address
4. Website
5. E-mail id
6. Financial Year reported
7. Sector(s) that the Company is engaged in (industrial activity code-wise)
8. List three key products/services that the Company manufactures/provides (as in balance sheet)
9. Total number of locations where business activity is undertaken by the Company
   (i) Number of International Locations (Provide details of major 5)
   (ii) Number of National Locations
10. Markets served by the Company – Local/State/National/International/

**Section B: Financial Details of the Company**

1. Paid up Capital (INR)
2. Total Turnover (INR)
3. Total profit after taxes (INR)
4. Total Spending on Corporate Social Responsibility (CSR) as percentage of profit after tax (%)
5. List of activities in which expenditure in 4 above has been incurred:
   a.
   b.
   c.

Section C: Other Details
1. Does the Company have any Subsidiary Company/Companies?
2. Do the Subsidiary Company/Companies participate in the BR Initiatives of the parent company? If yes, then indicate the number of such subsidiary company(s)
3. Do any other entity/entities (e.g. suppliers, distributors etc.) that the Company does business with, participate in the BR initiatives of the Company? If yes, then indicate the percentage of such entity/entities? [Less than 30%, 30-60%, More than 60%]

Section D: BR Information
1. Details of Director/Directors responsible for BR
(a) Details of the Director/Director responsible for implementation of the BR policy/policies
   • DIN Number
   • Name
   • Designation

(b) Details of the BR head

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Particulars</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>DIN Number if applicable</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Name</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Designation</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Telephone Number</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>e-mail id</td>
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</table>

(2) Principle-wise (as per NVGs) BR Policy/policies (Reply in Y/N)

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Questions</th>
<th>P1</th>
<th>P2</th>
<th>P3</th>
<th>P4</th>
<th>P5</th>
<th>P6</th>
<th>P7</th>
<th>P8</th>
<th>P9</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Do you have a policy/policies for….</td>
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<td>2</td>
<td>Has the policy being formulated in consultation with the relevant stakeholders</td>
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<td></td>
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<tr>
<td>3</td>
<td>Does the policy conform to any national/ international standards. If yes, specify? (50 words)</td>
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<td></td>
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<tr>
<td>4</td>
<td>Has the policy being approved by the Board? If yes, has it been signed by MD/owner/CEO/ Appropriate Board Directors</td>
<td></td>
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<tr>
<td>5</td>
<td>Does the company have a specified committee of the Board/Official to oversee the implementation of the policy?</td>
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</tbody>
</table>
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)

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The company has not understood the Principles</td>
</tr>
<tr>
<td>2</td>
<td>The company is not at a stage where it finds itself in a position to formulate and implement the policies on specified principles.</td>
</tr>
<tr>
<td>3</td>
<td>The company does not have financial or manpower resources available for the task</td>
</tr>
<tr>
<td>4</td>
<td>It is planned to be done within the next 6 months</td>
</tr>
<tr>
<td>5</td>
<td>It is planned to be done within the next 1 year</td>
</tr>
<tr>
<td>6</td>
<td>Any other reason (please specify)</td>
</tr>
</tbody>
</table>

3. Governance related to BR

- Indicate the frequency with which the Board of Directors, Committee of the Board or CEO to assess the BR performance of the Company. Within 3 months, 3-6 months, Annually, More than 1 year
- Does the Company publish a BR or a Sustainability Report? What is the hyperlink for viewing this report? How frequently it is published?

Section E: Principle-wise performance

Principle 1

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.
Lesson 15  Corporate Sustainability Reporting Frameworks

Principle 2

1. List up to 3 of your products or services whose design has incorporated social or environmental concerns, risks and/or opportunities.
   i. 
   ii. 
   iii. 

2. For each such product, provide the following details in respect of resource use (energy, water, raw material etc.) per unit of product (optional):
   i. Reduction during sourcing/production/distribution achieved since the previous year throughout the value chain?
   ii. Reduction during usage by consumers (energy, water) has been achieved since the previous year?

3. Does the company have procedures in place for sustainable sourcing (including transportation)?
   i. If yes, what percentage of your inputs was sourced sustainably? Also, provide details thereof, in about 50 words or so.

4. Has the company taken any steps to procure goods and services from local & small producers, including communities surrounding their place of work?
   If yes, what steps have been taken to improve their capacity and capability of local and small vendors? P

5. Does the company have a mechanism to recycle products and waste? If yes what is the percentage of recycling of products and waste (separately as <5%, 5-10%, >10%). Also, provide details thereof, in about 50 words or so.

Principle 3

1. Please indicate the Total number of employees.

2. Please indicate the Total number of employees hired on temporary/contractual/casual basis.

3. Please indicate the Number of permanent women employees.

4. Please indicate the Number of permanent employees with disabilities

5. Do you have an employee association that is recognized by management.

6. What percentage of your permanent employees is members of this recognized employee association?

7. Please indicate the Number of complaints relating to child labour, forced labour, involuntary labour, sexual harassment in the last financial year and pending, as on the end of the financial year.

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Catagory</th>
<th>No. of complaints filed during the financial year</th>
<th>No. of complaints pending as on end of this the financial year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Child labour/forced labour/involuntary labour</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Sexual harassment</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
3. **Discriminatory employment**

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 percentage was satisfactorily resolved by the management?

**Principle 6**

1. Does the policy related to Principle 6 cover only the company or extends to the Group/Joint Ventures/Suppliers/Contractors/NGOs/ others.

2. Does the company have strategies/ initiatives to address global environmental issues such as climate change, global warming, etc? Y/N. If yes, please give hyperlink for webpage etc.

3. Does the company identify and assess potential environmental risks? Y/N

4. Does the company have any project related to Clean Development Mechanism? If so, provide details thereof, in about 50 words or so. Also, if Yes, whether any environmental compliance report is filed?

5. Has the company undertaken any other initiatives on – clean technology, energy efficiency, renewable energy, etc. Y/N. If yes, please give hyperlink for webpage etc.

6. Are the Emissions/Waste generated by the company within the permissible limits given by CPCB/SPCB for the financial year being reported?

7. Number of show cause/ legal notices received from CPCB/SPCB which are pending (i.e. not resolved to satisfaction) as on end of Financial Year.

**Principle 7**

1. Is your company a member of any trade and chamber or association? If Yes, Name only those
major ones that your business deals with:

a.

b.

c.

d.

2. Have you advocated/lobbied through above associations for the advancement or improvement of public good? Yes/No; if yes specify the broad areas (drop box: Governance and Administration, Economic Reforms, Inclusive Development Policies, Energy security, Water, Food Security, Sustainable Business Principles, Others)

**Principle 8**

1. Does the company have specified programmes/initiatives/projects in pursuit of the policy related to Principle 8? If yes details thereof.

2. Are the programmes/projects undertaken through in-house team/own foundation/external NGO/government structures/any other organization?

3. Have you done any impact assessment of your initiative?

4. What is your company’s direct contribution to community development projects- Amount in INR and the details of the projects undertaken.

5. Have you taken steps to ensure that this community development initiative is successfully adopted by the community? Please explain in 50 words, or so.

**Principle 9**

1. What percentage of customer complaints/consumer cases are pending as on the end of financial year.

2. Does the company display product information on the product label, over and above what is mandated as per local laws? Yes/No/N.A./Remarks(additional information)

3. Is there any case filed by any stakeholder against the company regarding unfair trade practices, irresponsible advertising and/or anti-competitive behaviour during the last five years and pending as on end of financial year. If so, provide details thereof, in about 50 words or so.

4. Did your company carry out any consumer survey/consumer satisfaction trends?

**CHALLENGES IN MAINSTREAMING SUSTAINABILITY REPORTING**

Since the Sustainability Reporting is relatively a new concept, many organization find it difficult to prepare sustainability. Following may be considered as the challenges in mainstreaming sustainability reporting:

1. **Government Encouragement**: In many jurisdictions, there are no guidelines on sustainability reporting to encourage the corporate sector. While on the other hand, there are voluntary as well as mandatory guidelines from regulators for reporting on Sustainability aspects like in India we have SEBI framework of Business Responsibility Report. In South Africa, listed companies are required to prepare Integrated Report which is one step ahead of sustainability reporting. It is the need of the hour, that governments should encourage the corporate in their jurisdiction to adopt the sustainability reporting as a measure of good corporate governance.
2. **Awareness**: lack of awareness about the emerging concept of sustainability reporting is also a major challenge which the government and corporate governance bodies need to address by arranging the sustainability awareness programme for the Professionals, Board of Directors and Management in the corporate sector, as these are the persons who will drive sustainability reporting initiative for an organisation. The government/regulators should organize such awareness programme jointly with the experts in the field of Sustainability Reporting.

3. **Expertise Knowledge**: Sustainability Reporting is relatively a new concept in many jurisdictions and organization found it very difficult to prepare a sustainability report in the absence of expert guidance on the subject. The Sustainability Reporting concept is emerging as a good tool to showcase the corporate governance practices of an organisation and this area demand professionals having expert knowledge of sustainability reporting. The professional bodies in various jurisdictions should impart the expert knowledge of sustainability reporting to their members to develop a good cadre of experts in this emerging area of sustainability reporting.

4. **Investor Behaviour**: It is a recognized principle that investors should consider the Environmental, Social and Governance (ESG) issues while making investment decisions. There are specific regulators guidelines for the institutional investor to be vigilant on voting aspects and be concerned about the governance practices of the companies in which they invest. However, the investor behaviour may vary from company to company and sometimes they invest in companies without considering the ESG issues either due to lack of awareness on ESG issues or some other business reasons. It should be made a practice that the investor fund flow to those organization following the good governance including reporting on sustainability aspects.

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**Case Study - Sustainability Report of ITC Limited**

ITC reports its performance on an annual basis and the last Sustainability Report was published in June 2015. It is the 12th Sustainability Report of the Company covering the sustainability performance for the period from April 1, 2014 to March 31, 2015. ITC is headquartered at Virginia House, 37 J L Nehru Road, Kolkata, 700 071 (India).

The reporting principles and methodology of ITC are in accordance with the "Comprehensive" option of the fourth generation Global Reporting Initiative (GRI) Sustainability Reporting Guidelines - G4. The Reporting Principles and Standard Disclosures and the Implementation Manual of the GRI-G4 Reporting Guidelines have been followed. The relevant aspects/indicators from GRI-G4 Food Sector supplement have also been considered while reporting the Foods Business performance.

ITC has also linked Sustainability Report 2015 to Business Responsibility Report Principles to assess compliance with Environmental, Social and Governance (ESG) norms.

The Report of ITC highlights the Triple Bottom Line dimensions that reflect the organisation's significant economic, environmental and social impacts, or substantively influence the assessments and decisions of stakeholders.

ITC's Businesses/Units proactively engage with key stakeholders, who either have a major interest or are significantly affected by the Company's operations, products or services. The details on stakeholder engagement are also covered in the Report.

ITC has incorporated in its Report, the performance of 22 exclusive Third Party Manufacturers (TPMs) catering to the Notebooks segment of Education and Stationery Products Business and 2 TPMs of Cigarettes Business and ATC Limited, an associate company of ITC.
The economic performance reported is excerpted from the Company's Report & Accounts (R&A) 2015, audited by independent External Auditors - M/s Deloitte Haskins & Sells.

The data in the environment & social sections of the Report is based on actual performance of the various businesses, factories, hotels and large offices of the Company, TPMs and subsidiary companies as detailed in the reporting boundary.

An Integrated Sustainability Data Management System was established in the Company to collect, collate and analyse environmental and social data, along with strong internal controls, support overall integrity and credibility of the disclosures in the Report.

In order to obtain an objective and impartial assurance on the Report, ITC has been seeking the same from third party agencies on all its Sustainability Reports since it started reporting in 2004. In the current year, authenticity of the data and systems disclosed in Sustainability Report 2015 and conformance with 'in accordance' - comprehensive requirements of the GRI G4 guidelines has been verified by M/s KPMG, an independent third party assurance provider. They have conducted the assurance engagement as per the International Standard for Assurance Engagements (ISAE) 3000 and have provided assurance, at a 'reasonable level', the statement of which forms a part of this Report.

The assurance statement by M/s KPMG covering the summary of the work performed; the manner in which the assurance engagement has been conducted; the extent to which ITC has applied GRI G4 Guidelines and the conclusions on the Report is also included.


**Contemporary Developments - Integrated Reporting**

Integrated reporting is a new approach to corporate reporting which is rapidly gaining international recognition. Integrated reporting is founded on integrated thinking, which helps demonstrate interconnectivity of strategy, strategic objectives, performance, risk and incentives and helps to identify sources of value creation.

Integrated Reporting is one step ahead of sustainability reporting and its set to become the way companies report their annual financial and sustainability information together in one report. The aim of an integrated report is to clearly and concisely tell the organization’s stakeholders about the company and its strategy and risks, linking its financial and sustainability performance in a way that gives stakeholders a holistic view of the organization and its future prospects.

Ideally, an integrated report should be the organization’s primary report and from which all other detailed reports, such as the annual financial statements and sustainability report, flow. Importantly, integrated reporting includes forward-looking information to allow stakeholders to make a more informed assessment of the future of a company, as well as of how the organization is dealing with its sustainability risks and opportunities.

The King III Code on Governance defines an integrated report as “a holistic and integrated representation of the company’s performance in terms of both its finance and its sustainability”. In the light of recommendation of King Report on Governance for South Africa 2009 (King III), South Africa became the first country to require integrated reporting of all listed companies in the Johannesburg Stock Exchange. Companies that do not prepare an integrated report need to explain the reasons.

The International Integrated Reporting Council (IIRC) defines integrated reporting as “a process that
results in communication by an organization, most visibly a periodic integrated report, about how an organization’s strategy, governance, performance, and prospects lead to the creation of value over the short, medium and long-term.” It promotes a more cohesive and efficient approach to corporate reporting and aims to improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.

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 International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs promoting communication about value creation as the next step in the evolution of corporate reporting. It is not a regulator or a standard setter.

There have been major changes in the way business is conducted, how businesses create value, and the context in which they operate. These changes are interdependent and reflect trends in globalization, heightened expectations of corporate transparency and accountability, resource scarcity, and environmental concerns, among others. Some stakeholders are asking companies to provide clear information about emerging external drivers (e.g., political, social, and environmental) affecting their businesses, their approach to governance and managing risk, and how their business models work. In response to this growing demand for a broader information set, the IIRC is developing an integrated reporting framework to guide companies in communicating the information expected by stakeholders to assess a company’s longterm prospects.

Integrated thinking Integrated reporting would prompt companies to think about their reporting in an integrated manner. This would include, for example, considering the relationships between a company’s various operating and functional units, the financial and nonfinancial capitals that a company uses and affects, and the relevance of those factors in demonstrating how value is created. Some companies are starting to use integrated reporting concepts to drive their focus on integrated thinking and strategic decision-making. They're finding that this can lead to stronger cross-functional communications, more productive dialogue among employees at all levels across business activities, and more meaningful dialogue with external stakeholders. The current landscape Integrated reporting is being adopted or explored by companies throughout the world. An increasing number of social reporting requirements driven by local regulatory bodies and stock exchanges have played a key role in continuing this momentum. In South Africa, listed companies are required to adopt integrated reporting, as defined locally, or explain why they have not. Many other countries have enacted or proposed rules on integrated reporting and on incorporating corporate responsibility into a company’s external reporting. In the US, certain companies have shown an interest in reporting more non-financial information voluntarily. Recent research shows that nearly all of the S&P 500 companies made at least one sustainability related disclosure in their financial reports, though only seven of those companies claim to have published integrated reports.

Integrated Report

The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates value over time. An integrated report benefits all stakeholders interested in an organization’s ability to create value over time, including employees, customers, suppliers, business partners, local communities, legislators, regulators and policy-makers. The International Framework (the Framework) takes a principles-
based approach. The intent is to strike an appropriate balance between flexibility and prescription that recognizes the wide variation in individual circumstances of different organizations while enabling a sufficient degree of comparability across organizations to meet relevant information needs. It does not prescribe specific key performance indicators, measurement methods, or the disclosure of individual matters, but does include a small number of requirements that are to be applied before an integrated report can be said to be in accordance with the Framework. An integrated report may be prepared in response to existing compliance requirements, and may be either a standalone report or be included as a distinguishable, prominent and accessible part of another report or communication. It should include, transitionally on a comply or explain basis, a statement by those charged with governance accepting responsibility for the report.

**FUNDAMENTAL CONCEPTS**

An integrated report aims to provide insight about the resources and relationships used and affected by an organization – these are collectively referred to as “the capitals” in this Framework. It also seeks to explain how the organization interacts with the external environment and the capitals to create value over the short, medium and long term. The capitals are stocks of value that are increased, decreased or transformed through the activities and outputs of the organization. They are categorized in this Framework as financial, manufactured, intellectual, human, social and relationship, and natural capital, although organizations preparing an integrated report are not required to adopt this categorization or to structure their report along the lines of the capitals. The ability of an organization to create value for itself enables financial returns to the providers of financial capital. This is interrelated with the value the organization creates for stakeholders and society at large through a wide range of activities, interactions and relationships. When these are material to the organization’s ability to create value for itself, they are included in the integrated report.

**International Integrated Reporting Framework**

IIRC has developed an International Integrated Reporting Framework to establish Guiding Principles and Content Elements that govern the overall content of an integrated report, and to explain the fundamental concepts that underpin them. The Framework:

- Identifies information to be included in an integrated report for use in assessing the organization’s ability to create value; it does not set benchmarks for such things as the quality of an organization’s strategy or the level of its performance
- Is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.

The following Guiding Principles underpin the preparation of an integrated report, informing the content of the report and how information is presented:

- **Strategic focus and future orientation:** An integrated report should provide insight into the organization’s strategy, and how it relates to the organization’s ability to create value in the short, medium and long term, and to its use of and effects on the capitals
- **Connectivity of information:** An integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organization’s ability to create value over time
- **Stakeholder relationships:** An integrated report should provide insight into the nature and quality of the organization’s relationships with its key stakeholders, including how and to what extent the organization understands, takes into account and responds to their legitimate needs and interests
• **Materiality:** An integrated report should disclose information about matters that substantively affect the organization’s ability to create value over the short, medium and long term

• **Conciseness:** An integrated report should be concise

• **Reliability and completeness:** An integrated report should include all material matters, both positive and negative, in a balanced way and without material error

• **Consistency and comparability:** The information in an integrated report should be presented: (a) on a basis that is consistent over time; and (b) in a way that enables comparison with other organizations to the extent it is material to the organization’s own ability to create value over time.

An integrated report should include eight Content Elements that are fundamentally linked to each other and are not mutually exclusive:

1. **Organizational overview and external environment:** What does the organization do and what are the circumstances under which it operates?

2. **Governance:** How does the organization’s governance structure support its ability to create value in the short, medium and long term?

3. **Business model:** What is the organization’s business model?

4. **Risks and opportunities:** What are the specific risks and opportunities that affect the organization’s ability to create value over the short, medium and long term, and how is the organization dealing with them?

5. **Strategy and resource allocation:** Where does the organization want to go and how does it intend to get there?

6. **Performance:** To what extent has the organization achieved its strategic objectives for the period and what are its outcomes in terms of effects on the capitals?

7. **Outlook:** What challenges and uncertainties is the organization likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?

8. **Basis of presentation:** How does the organization determine what matters to include in the integrated report and how are such matters quantified or evaluated?

**RELATION BETWEEN INTEGRATED REPORTING AND SUSTAINABILITY REPORTING**

Sustainability reporting is a process that assists organizations in setting goals, measuring performance and managing change towards a sustainable global economy – one that combines long term profitability with social responsibility and environmental care. Sustainability reporting – mainly through but not limited to a sustainability report – is the key platform for communicating the organization’s economic, environmental, social and governance performance, reflecting positive and negative impacts. The Aspects that the organization deems to be material, in response to its stakeholders’ expectations and interests, drive sustainability reporting. Stakeholders can include those who are invested in 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.

**LESSON ROUND-UP**

- Corporate sustainability is imperative for the long-term sustainable development of the economy and society.
- The term sustainability accounting is used to describe the new information management and accounting methods that aim to create and provide high quality information to support a corporation in its movement towards sustainability.
- Sustainability reporting describes new formalized means of communication which provides information about corporate sustainability.
- The Sustainability Reporting Guidelines developed by the Global Reporting Initiative (GRI), the Netherlands, is a significant system that integrates sustainability issues into a frame of reporting.
- There are three elements of the GRI Sustainability Reporting Guidelines, viz. Reporting Principles, Reporting Guidance and Standard Disclosures (including performance indicators).
- Communications on Progress (COP) is a report to inform the company’s stakeholders about the company’s progress in implementing the Global Compact’s ten principles. The purpose of the COP is both to ensure and deepen the commitment of Global Compact participants and to safeguard the integrity of the initiative.
- Corporate sustainability reports are usually developed either by employees from the environment or sustainability department or from corporate communications unit or by external agency.
- Investors increasingly recognize the value of robust sustainability reporting and expectations for such reporting have spread to companies in emerging markets. Increasingly global companies understand that a commitment to sustainability reporting can contribute to financial success.
- Securities and Exchange Board of India (SEBI) vide circular CIR/CFD/DIL/ 8/2012 dated August 13, 2012 had inserted a new Clause 55 in the Listing Agreement by mandating inclusion of Business Responsibility Reports ("BR reports") as part of the Annual Reports for listed entities. The circular states that the adoption of responsible business practices in the interest of the social set-up and the environment are as vital as their financial and operational performance. Now SEBI has included the inclusion of BRR in SEBI (Listing Obligations and Disclosures Requirements) 2015.
- Principle for Responsible Investment aims to help investors integrate the consideration of environmental, social and governance (ESG) issues into investment decision-making and ownership practices across all asset classes and regions, and in so doing, help contribute to the creation of a sustainable financial system.
- Challenges in mainstreaming sustainability reporting are lack of (i) government encouragement; (ii) awareness about the sustainability reporting, (iii) Expertise Knowledge (iv) Investor behavior towards ESG parameters.
## SELF-TEST QUESTIONS

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

1. Discuss in detail about Global Reporting Initiative.
2. What are the benefits of reporting as per the communication of progress under the UN Global Compact?
3. Describe about the criteria of assessment under the Dow- Jones Sustainability Index.
4. Discuss about the Business Responsibility Reporting in India.
5. Write Short Notes on:
   - UN Principle for Responsible Investment
   - CSR Reporting Framework
Lesson 16
Legal Framework, Conventions, Treaties on Environmental and Social Aspects

LESSON OUTLINE

- Introduction
- UN Conference on Human Environment
- UN Environment Programme
- Brundtland Commission
- UN Conference on Environment and Development
- Rio Declaration on Environment and Development
- Statement of Forest Principles
- UN Framework Convention on Climate Change
- Convention on Biological Diversity
- Kyoto Protocol
- Bali Roadmap
- United Nations Conference on Sustainable Development (Rio+20)
- Millennium Development Goals
- International Labour Organisation
- Environmental Protection in India
- Ecomark
- Lesson Round-Up
- Self Test Questions

LEARNING OBJECTIVES

The objective of this study lesson is to enable the students to become aware of various conventions and treaties on environmental and social aspects including:

- United Nations Conference on Human Environment
- United Nations Environment Programme
- Brundtland Commission
- United Nations Conference on Environment and Development
- Kyoto Protocol
- Bali Roadmap
- United Nations Conference on Sustainable Development (Rio+20)
- Millennium Development Goals
- International Forest Carbon Initiative
- International Labour Organisation
- Environment Protection in India
INTRODUCTION

Corporate sustainability is a business approach that creates long-term shareholder value by embracing opportunities and managing risks arising from economic, environmental and social developments.

While corporate sustainability recognizes that corporate growth and profitability are important, it requires the corporation to pursue societal goals, specifically those relating to sustainable development - environmental protection, social justice, equity, and economic development.

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.

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)
Lesson 16 - Legal Framework, Conventions, Treaties on Environmental and Social Aspects

— 1992 - UN Conference on Environment and Development (Earth Summit) publishes Agenda 21, a blueprint for sustainable development

— 1992 - Convention on Biological Diversity


— 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


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.

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.”


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.

A. Agenda 21

Agenda 21 – a blueprint for sustainable development into the 21st century was agreed during the "Earth Summit" at Rio in 1992, and signed by 179 Heads of State and Government.

Agenda 21 is a guide for individuals, businesses and governments in making choices for the development that would help the society and environment. Agenda 21 deals with:

1. Social and economic dimensions: developing countries; poverty; consumption patterns; population; health; human settlements; integrating environment and development.

2. Conservation and management of resources: atmosphere; land; forests; deserts; mountains; agriculture; biodiversity; biotechnology; oceans; fresh water; toxic chemicals; hazardous radioactive and solid waste and sewage.

3. Strengthening the role of major groups: women; children and youth; indigenous peoples; non-governmental organisations; local authorities; workers; business and industry; farmers; scientists and technologists.

4. Means of implementation: finance; technology transfer; science; education; capacity-building; international institutions; legal measures; information.

B. Rio Declaration on Environment and Development

The Rio Declaration on Environment and Development consists of following 27 principles intended to guide future sustainable development around the world.

1. Human beings are at the centre of concerns for sustainable development. They are entitled to a healthy and productive life in harmony with nature.

2. States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental and developmental policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other states or of areas beyond the limits of their national jurisdiction.

3. The right to development must be fulfilled so as to equitably meet developmental and environmental needs of the present and future generations.

4. In order to achieve sustainable development, environmental protection shall constitute an integral part of
the development process, hence it cannot be considered in isolation.

5. All States and all people shall cooperate in the essential task of eradicating poverty as an indispensable requirement for sustainable development, in order to decrease the disparities in the standards of living, and strive to meet the needs of the majority of the people in the world.

6. The special situation and needs of developing countries, particularly the least developed ones and those that are most environmentally vulnerable, shall be given special priority. International actions in the field of environment and development should also address the interests and needs of all countries.

7. States shall cooperate in a spirit of global partnership to conserve, protect and restore the health and integrity of the Earth's ecosystem. In view of the different contributions to global environmental degradation, States have common but differentiated responsibilities. The developed countries acknowledge the responsibility that they bear in the international pursuit to sustainable development in view of the pressures their societies place on the global environment and of the technologies and financial resources they command.

8. To achieve sustainable development and a higher quality of life for all people, States should reduce and eliminate unsustainable patterns of production and consumption, and promote appropriate demographic policies.

9. States should cooperate to strengthen endogenous capacity-building for sustainable development by improving scientific understanding through exchanges of technological knowledge, and by enhancing the development, adaptation, diffusion and transfer of innovative technologies.

10. Environmental issues are best handled with no participation of all concerned citizens, at the relevant level. At the national level, each individual shall have appropriate access to the information held by public authorities concerning the environment including information on hazardous materials and activities prevalent in their respective community, and the opportunity to participate in decision-making processes. States shall facilitate and encourage public awareness and participation by making information widely available. Effective access to judicial and administrative proceedings, including redress and remedy, shall be provided.

11. States shall enact effective environmental legislation. Environmental standards, management objectives and priorities should reflect the environmental and development context to which they apply. Standards applied by some countries may be inappropriate and of unwarranted economic and social cost to other countries, particularly to the developing countries.

12. States should cooperate to promote a supportive and open international economic system that would lead to the economic growth and sustainable development in all countries, in order to address the problems of environmental degradation better. Trade policy measures for environmental purposes should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade. Unilateral actions to deal with environmental challenges outside the jurisdiction of the importing country should be avoided. Environmental measures addressing transboundary or global environmental problems should, as far as possible, be based on an international consensus.

13. States shall develop national law regarding liability and compensation for the victims of pollution and other environmental damage. States shall also cooperate in an expeditious and more determined manner to develop further international law regarding liability and compensation for adverse effects of environmental damage caused by activities within their jurisdiction or control to areas beyond their jurisdiction.

14. States should effectively cooperate to discourage or prevent the relocation and transfer to other States of
any activities and substances that cause severe environmental degradation or are found to be harmful to human health.

15. In order to protect the environment, the precautionary approach shall be widely applied by States according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.

16. National authorities should endeavour to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investment.

17. Environmental impact assessment, as a national instrument, shall be undertaken for proposed activities that are likely to have a significant adverse impact on the environment and are subject to decision of a competent national authority.

18. States shall immediately notify other States of any natural disasters or other emergencies that are likely to produce sudden harmful effects on the environment of those States. Every effort shall be made by the international community to help States so afflicted.

19. States shall provide prior and timely notification and relevant information to potentially affected States on activities that may have a significant adverse transboundary environmental effect and shall consult with those States at an early stage and in good faith.

20. Women have a vital role in environmental management and development. Their full participation is therefore essential to achieve sustainable development.

21. The creativity, ideals and courage of the youth of the world should be mobilized to forge a global partnership in order to achieve sustainable development and ensure a better future for all.

22. Indigenous people and their communities and other local communities have a vital role in environmental management and development because of their knowledge and traditional practices. States should recognize and duly support their identity, culture and interests and enable their effective participation in the achievement of sustainable development.

23. The environment and natural resources of people under oppression, domination and occupation shall be protected.

24. Warfare is inherently destructive of sustainable development. States shall therefore respect international law providing protection for the environment in times of armed conflict and cooperate in its further development, as necessary.

25. Peace, development and environmental protection are interdependent and indivisible.

26. States shall resolve all their environmental disputes peacefully and by appropriate means in accordance with the Charter of the United Nations.

27. States and people shall cooperate in good faith and in a spirit of partnership in the fulfilment of the principles embodied in this Declaration and in the further development of international law in the field of sustainable development.

C. Statement of Forest Principles

It is a Non-Legally Binding Authoritative Statement of Principles for a Global Consensus on the Management, Conservation and Sustainable Development of all types of Forests. The guiding objective of these principles
is to contribute to the management, conservation and sustainable development of forests, and to provide for their multiple and complementary functions and uses.

**D. United Nations Framework Convention on Climate Change**

The United Nations Framework Convention on Climate Change (UNFCCC or FCCC) is an international environmental treaty made at the United Nations Conference on Environment and Development (UNCED). The treaty is aimed at stabilizing greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic (due to human activity) interference with the climate system.

Signatories to the UNFCCC are divided into three groups:
- Annex I countries (industrialized countries)
- Annex II countries (developed countries which pay for the costs of developing countries)
- Developing countries.

Annex I countries agree to reduce their emissions (particularly carbon dioxide) to target levels below their 1990 emissions levels. If they cannot do so, they must buy emission credits or invest in conservation. Annex II countries, which have to provide financial resources for the developing countries, are a sub-group of the Annex I countries consisting of the OECD members.

Developing countries have no immediate restrictions under the UNFCCC. This serves three purposes:
- Avoids restrictions on growth because pollution is strongly linked to industrial growth, and developing economies can potentially grow very fast.
- It means that they cannot sell emissions credits to industrialized nations to permit those nations to over-pollute.
- They get money and technologies from the developed countries in Annex II.

Developing countries may volunteer to become Annex I countries when they are sufficiently developed.

Developing countries are not expected to implement their commitments under the Convention unless developed countries supply enough funding and technology, and this has lower priority than economic and social development and dealing with poverty.

**E. Convention on Biological Diversity**

The Convention on Biological Diversity, known informally as the Biodiversity Convention, is an international treaty that was adopted in Rio de Janeiro in June 1992. The Convention has three main goals:

1. conservation of biological diversity;
2. sustainable use of its components; and
3. fair and equitable sharing of benefits arising from genetic resources.

In other words, its objective is to develop national strategies for the conservation and sustainable use of biological diversity. It is often seen as the key document regarding sustainable development.

Some of the issues dealt within the convention include:
- Measures and incentives for the conservation and sustainable use of biological diversity.
- Regulated access to genetic resources and traditional knowledge, including Prior Informed Consent of the party providing resources.
- Sharing, in a fair and equitable way, the results of research and development and the benefits
arising from the commercial and other utilization of genetic resources with the Contracting Party providing such resources (governments and/or local communities providing the traditional knowledge or biodiversity resources utilized).

— Access to and transfer of technology, including biotechnology, to the governments and/or local communities that provide traditional knowledge and/or biodiversity resources.

— Technical and scientific cooperation.

— Impact assessment.

— Education and public awareness.

— Provision of financial resources.

— National reporting on efforts to implement treaty commitments.

### F. Montreal Protocol on Substances that Deplete the Ozone Layer

It is a protocol of the Vienna Convention for the Protection of the Ozone Layer, an international treaty designed to protect the ozone layer by phasing out the production of numerous substances believed to be responsible for ozone depletion. The treaty was opened for signature on 16 September 1987, and entered into force on 1 January 1989, followed by a first meeting in Helsinki, May 1989. Since then, it has undergone seven revisions, in 1990 (London), 1991 (Nairobi), 1992 (Copenhagen), 1993 (Bangkok), 1995 (Vienna), 1997 (Montreal), and 1999 (Beijing). Due to its widespread adoption and implementation it has been hailed as an example of exceptional international cooperation. Since the Montreal Protocol came into effect, the atmospheric concentrations of the most important chlorofluorocarbons and related chlorinated hydrocarbons have either leveled off or decreased. It is believed that if the international agreement is adhered to the ozone layer is expected to recover by 2050.

A Multilateral Fund for the Implementation of the Montreal Protocol was set up. The main objective of it is to assist developing countries that are parties to the Montreal Protocol and whose annual per capita consumption and production of ozone depleting substances (ODS) is less than 0.3 kg, to comply with the control measures of the Protocol. Currently, 147 of the 196 Parties to the Montreal Protocol meet these criteria. It embodies the principle agreed at the United Nations Conference on Environment and Development in 1992 that countries have a common but differentiated responsibility to protect and manage the global commons.

### 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. These 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 in GHG 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 of GHGs 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 they can use towards meeting their commitments. These mechanisms help identify lowest-cost opportunities for reducing emissions and 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 binding 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).
The United Nations Conference on Sustainable Development (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 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 Conference also galvanized the attention of thousands of representatives of the UN system and major groups. It resulted in over 700 voluntary commitments and witnessed the formation of new partnerships to advance sustainable development.

(For more details on Rio+20, student may refer the link: http://sustainabledevelopment.un.org/rio20.html)

Millennium Development Goals to Sustainable Development Goals

The Millennium Development Goals (MDGs) are 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 are:

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.

The Rio+20 vision of sustainable development as a holistic concept addresses four dimensions of society: economic development (including the end of extreme poverty), social inclusion, environmental sustainability, and good governance including peace and security. Societies aim to achieve all four dimensions. Failures in one area, such as environmental sustainability or gender equality, can undermine progress in others, such as the eradication of poverty. Poor governance and insecurity can all too easily undermine progress on economic, social, and environmental objectives.

Some important outcomes include the following:

Supporting the development of Sustainable Development Goals (SDGs), a set of measurable targets aimed at promoting sustainable development globally has been set up. It is thought that the SDGs will pick up where the Millenium Development Goals leave off, and address criticism that the original Goals fail to address regarding the role of the environment in development."
Nations agreed to explore alternatives to GDP as a measure of wealth that take environmental and social factors into account in an effort to assess and pay for ‘environmental services’ provided by nature, such as carbon sequestration and habitat protection.

Recognition that “fundamental changes in the way societies consume and produce are indispensable for achieving global sustainable development.” EU officials suggest it could lead to a shift of taxes so workers pay less and polluters and landfill operators pay more. All nations reaffirmed commitments to phase out fossil fuel subsidies.

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 UNGA. The outcome document mandated the creation of an inter-governmental Open Working Group that will submit a report to the UN General Assembly containing a proposal for consideration and appropriate action to be taken for sustainable development goals.

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.

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**
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

8. International Forest Carbon Initiative

The International Forest Carbon Initiative is a key part of Australia’s international leadership on reducing emissions from deforestation. The initiative will support international efforts to reduce deforestation through the United Nations Framework Convention on Climate Change (UNFCCC). It aims to demonstrate that reducing emissions from deforestation and forest degradation can be part of an equitable and effective international agreement on climate change. A central element is the initiative’s focus on developing practical demonstration, particularly in Indonesia and Papua New Guinea.

9. International Labour Organisation (ILO)

The International Labour Organisation (ILO) was created in 1919, as part of the Treaty of Versailles that ended World War I, to reflect the belief that universal and lasting peace can be accomplished only if it is based on social justice. The security, humanitarian, political and economic considerations were the driving force behind the creation of ILO.

There was keen appreciation of the importance of social justice in securing peace, against a background of exploitation of workers in the industrializing nations of that time. There was also increasing understanding of the world’s economic interdependence and the need for cooperation to obtain similarity of working conditions in countries competing for markets. Reflecting these ideas, the Preamble states:

— Whereas universal and lasting peace can be established only if it is based upon social justice;
— And whereas conditions of labour exist involving such injustice, hardship and privation to large numbers of people as to produce unrest so great that the peace and harmony of the world are imperilled; and an improvement of those conditions is urgently required;
— Whereas also the failure of any nation to adopt humane conditions of labour is an obstacle in the way of other nations which desire to improve the conditions in their own countries.

The areas of improvement listed in the Preamble remain relevant today, for example:

— Regulation of the hours of work including the establishment of a maximum working day and week;
— Regulation of labour supply, prevention of unemployment and provision of an adequate living wage;
— Protection of the worker against sickness, disease and injury arising out of employment;
— Protection of children, young persons and women;
— Provision for old age and injury, protection of the interests of workers when employed in countries other than their own;
— Recognition of the principle of equal remuneration for work of equal value;
— Recognition of the principle of freedom of association;
— Organization of vocational and technical education, and other measures.

The ILO is the only ‘tripartite’ United Nations agency that brings together representatives of governments, employers and workers to jointly shape policies and programmes to achieve its defined objectives.

**REGULATORY FRAMEWORK OF ENVIRONMENT PROTECTION IN INDIA**

In India, as in other developing countries, environmental problems are not merely confined to the side effects of industrialization, but they reflect the inadequacy of resources to provide infrastructural facilities to prevent industrial pollution. Other peculiar problems, like population, illiteracy and unemployment obviously also pose questions regarding the provision of food, water, shelter and sanitation. The Indian Penal Code, 1860 contains penal provisions for corrupting or fouling the water of any spring or reservoir so as to make it unusable as well as for vitiating the atmosphere by polluting it, thus by making it hazardous for people’s health. In 1977, an amendment to the Constitution of India, 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.

The primary responsibility for the implementation of the Policy of the Government of India with respect to environmental management, conservation, ecological sustainable development and pollution control rests with the Ministry of Environment and Forest (MoEF). To ensure that the economic growth and development in our country is in conformity with the regulations for environmental conservation, the Ministry of Environment and Forest has notified Environmental Impact Assessment Notification 2006. The MoEF is the agency responsible for the review and approval of Environmental Impact Assessment. Under this notification certain activities have to obtain clearance and No Objection Certificate from the Central and State Governments and also to obtain No Objection Certificate before the commencement of the operations.

International Cooperation and Sustainable Development Division (IC&SD) in the Ministry of Environment and Forests works in relation to international cooperation in the field of environment. The Division has also been entrusted with the additional responsibility of coordinating the sustainable development activities.

This division is the nodal division for the United Nations Environment Programme (UNEP), Nairobi, South Asia Cooperative Environment Programme (SACEP), Colombo. The Division also handles bilateral issues and matters pertaining to multilateral bodies, such as the Commission on Sustainable Development, Environment Support Programme of UNDP under Country Cooperation Framework - Global Environment Facility (GEF) and the regional bodies, like Economic & Social Commission for Asia & Pacific (ESCAP), South Asian Association for Regional Cooperation (SAARC), European Union (EU) and the India Canada Environment Facility.

The Ministry is the nodal agency in the Government for various environment related multilateral conventions and protocols. These include the Convention on International Trade in Endangered Species, Convention on Wetlands of International importance, especially the waterfowl habitat, Convention on the Conservation of Migratory Species of Wild Animal, Vienna Convention for the protection of the Ozone Layer, Montreal Protocol on Substances that deplete the Ozone Layer, Conventions on Biological Diversity, UN Framework Convention on Climate Change, Kyoto Protocol, the Basel Convention on Trans-boundary Movement of Hazardous Substances, Convention to Combat Desertification, Stockholm Convention on Persistent Organic Pollutants, etc.
India has been pursuing its commitments under various conventions vigorously by initiating several measures on regional and national level.

Environment related multilateral conventions and protocols, etc., are being handled by the respective technical and scientific divisions in the Ministry. IC&SD Division plays a coordinating role in the matters relating to these Conventions. A compendium on various environment related conventions is proposed to be brought out by the Division.

— The MoEF is responsible to enforce the Regulations established pursuant to major legal enactments which are as follows:

- **The Water (Prevention and Control of Pollution) Act** was enacted in 1974 to prevent and control water pollution, to maintain or restore the wholesomeness of water in the country. The Act was amended in 1988.

- **The Air (Prevention and Control of Pollution) Act** was enacted in 1981 and amended in 1987 to provide for the prevention, control and abatement of air pollution in India.

- **The Environment (Protection) Act** was enacted in 1986 with the objective of providing for the protection and improvement of the environment. It empowers the Central Government to establish authorities [under section 3(3)] charged with the mandate of preventing environmental pollution in all its forms and to tackle specific environmental problems that are peculiar to different parts of the country. The Act was last amended in 1991.

- The main objective of the **Public Liability Insurance Act 1991** is meant to provide for the damages suffered victims as a result of an accident occurring by the handling of a hazardous substance. The Act applies to all owners associated with the production or handling of any hazardous chemicals.

- **National Green Tribunal (NGT):** The National Green Tribunal has been established on 18.10.2010 under the National Green Tribunal Act 2010 for effective and expeditious disposal of cases relating to environmental protection and conservation of forests, and other natural resources. It is a specialized body equipped with the necessary expertise to handle environmental disputes involving multi-disciplinary issues. The Tribunal shall not be bound by the procedure laid down under the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice.

  - The Tribunal's dedicated jurisdiction in environmental matters shall provide speedy environmental justice and help reduce the burden of litigation in the higher courts. The Tribunal is mandated to make and endeavour for the disposal of applications or appeals finally within 6 months of the filing of the case. Initially, it was proposed that the NGT would set up its settings at five places and would follow circuit procedure for making itself more accessible. New Delhi is the Principal Place of Sitting of the Tribunal, and Bhopal, Pune, Kolkata and Chennai shall be the other four place of sitting for the Tribunal.

  - The **Prevention of Cruelty to Animals Act** was enacted in 1960 to prevent the infliction of unnecessary pain or suffering on animals, and to amend the laws relating to the prevention of cruelty to animals. After the enactment of this Act, the Animal Board of India was formed for the promotion of animal welfare.

  - The Government of India enacted **Wild Life (Protection) Act 1972** with the objective of effectively protecting the wild life of this country, and to control poaching, smuggling and illegal trade in wildlife and its derivatives. The Act was amended in January 2003; and punishment
and penalty for offences under the Act have been made more stringent. The Ministry has proposed further amendments in the law by introducing more rigid measures to strengthen the Act. The objective is to provide protection to the listed endangered flora and fauna, and ecologically important protected areas.

- The **Scheduled Tribes and Other Traditional Forest Dwellers (Recognition of Forest Rights) Act, 2006**, recognizes the rights of forest-dwelling Scheduled Tribes and other traditional forest dwellers over the forest areas inhabited by them, and provides a framework for according the same.

- The **Biological Diversity Act 2002** was born out of India’s attempt to realise the objectives enshrined in the United Nations Convention on Biological Diversity (CBD) 1992, which recognizes the sovereign rights of states to use their own Biological Resources. The Act aims at the conservation of biological resources and associated knowledge as well as facilitating access to them in a sustainable manner and through a just process. For the purposes of implementing the objects of the Act it has established the National Biodiversity Authority in Chennai.

Apart from above these there are various regulations issued by the MoEF, details of which are available at: http://moef.nic.in/

### A Scheme on Labeling of Environment Friendly Products

To increase consumer awareness, the Government of India launched the eco-labeling scheme known as ‘**Ecomark**’ in 1991 for easy identification of environment-friendly products. Any product which is made, used or disposed of in a way that significantly reduces the harm it would otherwise cause to the environment could be considered as Environment-Friendly Product. The ‘Ecomark’ label is awarded to consumer goods which meet the specified environmental criteria and the quality requirements of Indian Standards. Any product with the Ecomark will be the right environmental choice.

An earthen pot has been chosen as the logo for the Ecomark scheme in India. The familiar earthen pot uses a renewable resource, like earth. It does not produce hazardous waste and consumes little energy in its making. Its solid and graceful form represents both strength and fragility, which also characterises the eco-system.

The specific objectives of the scheme are as follow:

- To provide an incentive for manufacturers and importers to reduce adverse environmental impact of products.
- To reward genuine initiatives by companies to reduce adverse environmental impact of their products.
- To assist consumers to become environmentally responsible in their daily lives by providing information to take account of environmental factors in their purchase decisions.
- To encourage citizens to purchase products which have less harmful impacts on environment.
- Ultimately to improve the quality of the environment and to encourage the sustainable management of resources.
Lesson 16 = Legal Framework, Conventions, Treaties on Environmental and Social Aspects

Enhance your Knowledge

Go through the following:
1. http://moef.nic.in/
2. http://www.cpcb.nic.in/
4. www.unglobalcompact.org/
5. www.unep.org
8. www.cbd.int/
9. www.ilo.org/

LESSON ROUND-UP

- Environmentalists claims that living things other than human beings, and the natural environment as a whole, are a major concern to be included in political, economic and social policies.
- The United Nations Conference on Human Environment met at Stockholm in 1972. The conference called upon the Governments and people to exert common efforts for the preservation and improvement of the human environment for the benefit of all the people and for their posterity.
- United Nations Environment Programme (UNEP), established in 1972, is the voice for the environment within the United Nation's system. UNEP acts as a catalyst, advocate, educator and facilitator to promote a wise use and sustainable development of the global environment.
- The Brundtland Commission, formally the World Commission on Environment and Development (WCED), known by the name of its Chair Gro Harlem Brundtland, was convened by the United Nations in 1983.
- "Sustainable development is development that meets the need of the present without compromising the ability of future generations to meet."
- The United Nations Commission on Sustainable Development was established by the UN General Assembly in December 1992 to ensure effective follow-up of United Nations Conference on Environment and Development, also known as the Earth Summit held in Rio De Janeiro.
- The documents that emerged out of the Rio Summit are – Agenda 21, the Rio Declaration on Environment and Development, the Statement of Forest Principles, the United Nations Framework Convention on Climate Change and the United Nations Convention on Biological Diversity.
- Rio+20 was a 20-year follow-up to the 1992 Earth Summit / United Nations Conference on Environment and Development (UNCED) held in the same city, and it was the 10th anniversary of the 2002 World Summit on Sustainable Development (WSSD) in Johannesburg.
- Statement of Forest Principles is a Non-Legally Binding Authoritative Statement of Principles for a Global Consensus on the Management, Conservation and Sustainable Development of all Types of Forests.
- The United Nations Framework Convention on Climate Change (UNFCCC or FCCC) is an international environmental treaty aimed at stabilizing greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system.
- The Convention on Biological Diversity is an international treaty, adopted in Rio de Janeiro in June 1992, has three main goals – conservation of biological diversity, sustainable use of its components and fair and equitable sharing of benefits arising from genetic resources.
The Kyoto Protocol 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.

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. The first commitment period of the Kyoto Protocol expired in 2012.

The International Forest Carbon Initiative is a key part of Australia’s international leadership on reducing emissions from deforestation. The initiative will support international efforts to reduce deforestation through the United Nations Framework Convention on Climate Change.

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 to finalizing a binding agreement in 2009 in Denmark.

The ILO was created in 1919, as part of the Treaty of Versailles that ended World War I, to reflect the belief that universal and lasting peace can be accomplished only if it is based on social justice. The driving forces for ILO’s creation arose from security, humanitarian, political and economic considerations.

Ministry of Environment and Forests, Government of India, has undertaken various initiatives including enactments of various laws, rules and regulations for the protection of environment and its related rights. Apart from this India is also a part of various conventions and protocols.

The National Green Tribunal has been established on 18.10.2010 under the National Green Tribunal Act 2010 for effective and expeditious disposal of cases relating to environmental protection and conservation of forests and other natural resources.

**SELF-TEST QUESTIONS**

1. Write short notes on:
   — United Nations Environment Programme
   — Brundtland Commission
   — International Labour Organisation

2. Discuss in detail the Kyoto Protocol and the Bali Roadmap.

3. Environmental Protection is the responsibility of the Government. In the light of the statement discuss major initiatives taken by the Indian Government and the role played by the citizen of India.

4. Briefly explain following:
   - National Green Tribunal
   - Rio + 20
   - Millennium Development Goals (MDGs)
Lesson 17
Principles of Absolute Liability

LESSON OUTLINE

• Introduction
• Rule in Rylands v. Fletcher
• Applicability of Rylands Doctrine in India
• Industrial Disasters
• Hazardous or inherently dangerous industry
• Departure from Rylands v. Fletcher
• Water Pollution
• Corporate Manslaughter and Corporate Homicide Act 2007, United Kingdom
• Conclusion
• Lesson Round-Up
• Self Test Questions

LEARNING OBJECTIVES

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

• The concept of Absolute Liability with the help of decided case law Ryland v. Fletcher.
• Applicability of Ryland Doctrine in India
• Industrial disasters
• Hazardous or inherently dangerous industry
• Water pollution
• About Corporate Manslaughter and Corporate Homicide Act 2007, United Kingdom
A rapid industrialization and competitiveness in industries has brought the environmental issues in industries to the lime light. The catastrophic accident at Bhopal in India, in December 1984, and similar such accidents in other parts of the world in the past have also drawn lot of concern of the world community regarding the environmental issues, safety and health conditions in industries. The popular perception about industries in general has been that they are environmental unfriendly and are the principal polluters. Industries too have strengthened such a view by taking their own time in adopting to cleaner technologies and in the observance of good business practices. The realization is yet to dawn on all the concerned that it would make perfect business sense to adopt and observe better standard technologies that cause least adverse impact on environment.

Often at times one finds the industry is opting to violate the regulations and pay the penalty instead, rather than conforming to them, as they find the cost of conformity dearer.

**Rule in Rylands v. Fletcher**

In the past all actions for environmental torts against companies and industries were governed by the principle of strict liability. Strict liability means liability without fault, i.e., without intention or negligence. In other words, the defendant is held liable without fault. Absolute liability for the escape of impounded waters was first established in England during the mid-nineteenth century in the case of Rylands v. Fletcher, (1868) LR 3 330. The rule was first stated by Blackburn, J. (Court of Exchequer) in the following words:

“We think that the rule of law is, that the person who for his own purposes brings on his lands and collects and keeps there anything likely to do mischief if it escapes, must keep it at his peril, and, if he does not so, is prima facie answerable for all the damage which is the natural consequence of its escape. He can excuse himself by showing that the escape was owing to the plaintiff’s default; or perhaps that the escape was the consequence of vis major or the act of God…… and it seems but reasonable and just that the neighbour, who has brought something on his own property which was not naturally there, harmless to others so long as it is confined to his own property, but which he knows to be mischievous if it gets on his neighbour’s, should be obliged to make good the damage which ensues if he does not succeed in confining it to his own property”.

This passage of Blackburn’s opinion established broad liability for land owners whose land development activities result in the unexpected release of a large volume of water.

The liability under this rule is strict and it is no defence to say that the thing escaped without that person’s willful act, default or neglect or even with the excuse that he had no previous knowledge of its existence. The House of Lords, however, added a rider to the above statement stating that – this rule applies only to non-natural user of the land and it does not apply to things naturally established on the land or where the thing escaped due to an act of God or an act of stranger or the default of the person injured or where the thing which escapes is present by the consent of the person injured or in certain cases where there is statutory authority.

American courts began dealing with Rylands, absolute liability soon after the House of Lords issued its Rylands opinion. The first American jurisdiction to apply the Rylands Doctrine was Massachusetts, where a court imposed absolute liability on a defendant who allowed filthy water to percolate into a neighbor’s well. Shortly thereafter, Minnesota adopted Rylands absolute liability in a case involving the breach of an
underground water tunnel. For several decades following these decisions, courts and commentators in the United States largely disapproved the Rylands doctrine.

**Applicability of Rylands Doctrine in India**

**Industrial Disasters**

**Bhopal Gas Disaster**

Bhopal Gas Disaster being the worst industrial disaster of the country has raised complex legal questions about the liability of a parent company for the act of its subsidiary, and the responsibility of multinational corporations engaged in hazardous activity and transfer of hazardous technology.

On the night of Dec. 2nd-3rd, 1984, the most tragic industrial disaster in history occurred in the city of Bhopal, Madhya Pradesh. Union Carbide Corporation (UCC), an American Corporation, with subsidiaries operating throughout the World had a chemical plant in Bhopal under the name Union Carbide India Ltd., (UCIL). The chemical plant manufactured pesticides called Seven and Temik. Methyl Isocyanate (MIC), a highly toxic gas is an ingredient in the production of both Seven and Temik. On the night of tragedy, MIC leaked from the plant in substantial quantities and the prevailing winds blew the deadly gas into the overpopulated hutments adjacent to the plants and into the most densely occupied parts of the city. The massive escape of lethal MIC gas from the Bhopal Plant into the atmosphere rained death and destruction upon the innocent and helpless people and caused widespread pollution to the environs in the worst industrial disaster mankind had ever known.

It was estimated that 2660 persons lost their lives and more than 2 lakh persons suffered injuries, some serious and permanent, some mild and temporary. Livestocks were killed and crops damaged. Normal business was interrupted.

On Dec 7th, 1984, the first law suit was filed by a group of American lawyers in the United States on behalf of thousands of Indians affected by the gas leak. All these actions were consolidated in the Federal Court of United States. On 29th Mar. 1985 the Government of India enacted a legislation called The Bhopal Gas Disaster (Processing of Claims) Act enabling itself to have the exclusive right to represent Indian plaintiffs as in India and also elsewhere in connection with the tragedy. Judge John F. Keenan of the US District Court after hearing both the parties dismissed the Indian consolidated case on the ground of forum non conveniens and declared that Indian Courts are the appropriate and convenient forum for hearing the plea of those affected.

The case moved to the Indian Courts, starting in the Bhopal High Court, till it finally reached the Supreme Court. Finally in, 1989, the Supreme Court of India came out with a over all settlement of claims and awarded U.S. $470 million to the Government of India on behalf of all Bhopal victims full and final settlement of all the past, present and future claims arising from the disaster.

**Hazardous or inherently dangerous industry**

What is the measure of liability of an enterprise which is engaged in a hazardous or inherently dangerous industry, where by any chance an accident occurs, persons die or get injured? Does the rule in *Rylands v. Fletcher* apply in such circumstances or is there any other principle by which the liability can be determined? This question was debated in *M.C. Mehta v. Union of India*, AIR 1987 SC 1086 commonly called oleum gas leak case.

Before discussing this case, it may be pointed out that that it came into limelight after it got originated in a writ petition filed in the Supreme Court by the environmentalist and lawyer M.C. Mehta, as a public interest
litigation. [M.C. Mehta and another (Petitioners) v. Union of India and others (Respondents) and Shriram Foods & Fertiliser Industries (Petitioners) v. Union of India (Respondents) AIR 1987 SC 965] The petition raised some seminal questions concerning the Arts.21 and 32 of the Constitution, the principles and norms for determining the liability of large enterprises engaged in manufacture and sale of hazardous products, the basis on which damage in case of such liability should be quantified, and whether such large enterprises should be allowed to continue to function in thickly populated areas and if they are permitted so to function. What measures must be taken for the purpose of reducing the hazard to the workmen and the community living in the neighbourhood to the minimum. These questions raised by the petitioner as they were thought to be of greatest importance, particularly following the leakage of MIC gas from the Union Carbide Plant in Bhopal. They were referred to the Constitutional Bench of the Apex Court subsequently in another writ petition, i.e., M.C. Mehta v. Union of India, AIR 1987 SC 1086 mentioned above.

The pressing issue which the Supreme Court had to decide immediately in the petition, was whether to allow the caustic chlorine plant of Shriram Foods & Fertiliser Industries to be restarted.

The accused Company, Delhi Cloth Mills Ltd., a public limited company having its registered office in Delhi, ran an enterprise called Shriram Foods and Fertilizer Industries. This enterprise had several units engaged in the manufacturing of caustic soda, chlorine and various other acids and chemicals.

On December 4, 1985 a major leakage of oleum gas took place from one of the units of Shriram, and this leakage affected a large number of people, both amongst the workmen and the public in general, and according to the petitioner, an advocate practicing in the Tis Hazari Court died on account of inhalation of oleum gas. The leakage resulted from the bursting of a tank containing oleum gas, as a result of the collapse of the structure on which it was mounted. This created a scare amongst the people residing in that area. Hardly had the people got out of the shock of this disaster when within two days, another leakage, though this time a minor one, took place as a result of escape of oleum gas from the joints of a pipe. The Delhi Administration issued two orders, on the behest of Public Health and Policy, to cease carrying on any further operation in the unit, and to remove such chemical and gases from there.

The Inspector of Factories and the Assistant Commissioner (Factories) issued separate orders on December 7 and 24, 1985 to shut down both the plants. Aggrieved, Shriram filed a writ petition challenging the two prohibitory orders issued under the Factories Act of 1948, and sought interim permission to reopen the caustic chlorine plant.

The Supreme Court, after examining the reports of the various committees that were constituted from time to time to examine the areas of concern and potential problems relating to the plant, as well as the existence of safety and pollution control measures, etc., held that pending consideration of the issue whether the caustic chlorine plant should be directed to be shifted and relocated at some other place, arrived at the conclusion that the caustic chlorine plant should be allowed to be restarted by the management subject to certain specified stringent conditions.

When science and technology are increasingly employed in producing goods and services calculated to improve the quality of life, there is certain element of hazard or risk inherent in the very use of technology and it is not always possible to totally eliminate such hazards or risks altogether. The Court said that it is not possible to adopt a policy of not having any chemical or other hazardous industries merely because they pose hazard or risk to the community. If such a policy was adopted, it would mean the end of all progress and development. Such industries, even if hazardous, have to be set up since they are essential for the economic development and advancement of well-being of the people. We can only hope to reduce the element of hazard or risk to the community by taking all necessary steps for locating such industries in a manner which would pose least risk or danger to the community by maximizing safety requirements.
Departure from Rylands v. Fletcher

Subsequently in *M.C. Mehta v. Union of India*, AIR 1987 SC 1086, the Supreme Court sought to make a departure from the accepted legal position in *Rylands v. Fletcher* stating that “an enterprise which is engaged in a hazardous or inherently dangerous activity that poses a potential threat to the health and safety of persons and owes an absolute and non-delegable duty to the community to ensure that no harm results to anyone. The principle of absolute liability is operative without any exceptions. It does not admit of the defences of reasonable and due care, unlike strict liability. Thus, when an enterprise is engaged in hazardous activity and harm result, it is absolutely liable, effectively tightening up the law.

Speaking on strict and absolute liability, the Apex Court (Hon’ble Chief Justice Bhagwati) stated:

“We cannot allow our judicial thinking to be constricted by reference to the law as it prevails in England or for the matter of that in any other foreign country. We no longer need the crutches of a foreign legal order. We are certainly prepared to receive light from whatever source it comes but we have to build up our own jurisprudence and we cannot countenance an argument that merely because the new law does not recognise the rule of strict and absolute liability in cases of hazardous or dangerous liability or the rule as laid down in *Rylands v. Fletcher* as is developed in England recognises certain limitations and responsibilities”.

The industries involving hazardous processes generally handle many toxic, reactive, and flammable chemical substances in the plant operations which are potential sources of different types of hazards at the workplace. If these hazards are not managed properly, the safety and health of the exposed population is adversely affected and they become vulnerable to a great risk.

Imposing an absolute and non-delegable duty on an enterprise which is engaged in a hazardous or inherently dangerous industry, the Supreme Court held that “in India we cannot hold our hands back at such a situation and wait for inspiration from England hence there is a need to venture so as to evolve a new principle of liability which England Courts have not done. We have to develop our own law and if we find that it is necessary to construct a new principle of liability to deal with an unusual situation which has arisen and which is likely to arise in future on account of hazardous or inherently dangerous industries which are concomitant to an industrial economy, there is no reason why we should hesitate to evolve such principle of liability merely because it has not been so done in England. We are of the view that an enterprise which is engaged in a hazardous or inherently dangerous industry which poses a potential threat to the health and safety of the persons working in the factory and residing in the surrounding areas owes an absolute and non-delegable duty to the community to ensure that no harm results to anyone on account of hazardous or inherently dangerous nature of the activity which it has undertaken”.

Further, the Apex Court held that the measure of compensation in these kind of cases must be correlated to the magnitude and capacity of the enterprise so that they certainly have a deterrent effect. The larger and more prosperous the enterprise, the greater must be the amount of compensation payable by it for the harm caused on account of an accident in carrying on of the hazardous or inherently dangerous activity by the enterprise.

In *Indian Council of Enviro-Legal Action v. Union of India*, AIR 1996 SC 1466, a writ petition was filed before the Supreme Court alleging invasion of right to life because of pollution caused by private companies. The Supreme Court reaffirmed the rule laid down in oleum gas leak case stating that once the activity carried on is hazardous or inherently dangerous, the person carrying on such activity is liable to make good the loss caused to any other person by his activity irrespective of the fact whether he took reasonable care while carrying on his activity is by far the most appropriate one and binding. The rule is premised upon the very nature of the activity carried on. In the words of the Constitution Bench, such an activity “can be tolerated only on the condition that the enterprise engaged in such hazardous or inherently dangerous activity..."
indemnifies all those who suffer on the account of the carrying on of such hazardous or inherently dangerous activity regardless of whether it is carried on carefully or not”. The Constitution bench has also assigned the reason for stating the law in the said terms. It is that the enterprise (carrying on of such hazardous or inherently dangerous activity) alone has the reason to discover and guard against hazards or dangers – and not the person affected, and the practical difficulty on the part of the affected person in establishing the absence of reasonable care or that the damage done to him was foreseeable by the enterprise.

Even if it is assumed that the Supreme Court cannot award damages against the private companies responsible for causing pollution in proceedings under Art. 32 that does not mean that the Supreme Court cannot direct the Central Government to determine and recover the cost of remedial measures from the private companies. The Central Government is empowered to take all measures and issue all such directions as are called for the above purpose. The Supreme Court can certainly give directions to the Central Government/its delegate to take all such measures, if in a given case the Court finds that such directions are warranted.

**Water Pollution**

Leather industry is one of the three major industries, besides paper and textiles, consuming large quantities of water for the processing of hides and skins into leather. Naturally, most of the water used is discharged as waste water containing putrescible organic and toxic inorganic materials. This when discharged as such depletes dissolved oxygen content of the receiving water courses resulting in the death of all aquatic life and emanating foul odour. The *M.C. Mehta v. Union of India* [AIR 1988 SC 1037], also known as the Kanpur Tanneries or Ganga Pollution case, is among the most significant water pollution case. Detailed scientific investigations and the reports related to it were produced before the Court as an evidence.

In the case following the alarming details given by M.C. Mehta about the extent of pollution in the river Ganga caused by the inflow of sewage from Kanpur alone, the Court came down heavily on the Nagar Mahapalika (Municipality). It emphasised that it is the Nagar Mahapalika of Kanpur that has to bear the major responsibility for the pollution of the river near Kanpur city. The Supreme Court held:

“Where in public interest litigation owners of some of the tanneries discharging effluents from their factories in Ganga and not setting up a primary treatment plant in spite of being asked to do so for several years did not care, in spite of notice to them, even to enter appearances in the Supreme Court to express their willingness to take appropriate steps to establish the pre-treatment plants it was held that so far as they were concerned on order directing them to stop working their tanneries should be passed. It was observed that the effluent discharged from a tannery is ten times noxious when compared with the domestic sewage water which flows into the river from any urban area on its bank. It was further observed that the financial capacity of the tanneries should be considered as irrelevant while requiring them to establish primary treatment plants. Just like an industry which cannot pay minimum wages to its worker cannot be allowed to exist, a tannery which cannot set up a primary treatment plant cannot be permitted to continue to be in existence for the adverse effect on the public at large which is likely to ensure by the discharging of the trade effluents from the tannery to the river Ganga would be immense and it will outweigh any inconvenience that may be caused to the management and the labour employed by it on account of its closure”.

In *Vineet Kumar Mathur v. Union of India* [(1996) 1 SCC 119], the Court took note of the continued violation of the State, as well as industries by continuing to pollute water by discharging effluents, and also in not setting up of common effluent treatment plants. The Court initially directed the officers of the State Pollution Board to visit the polluting industrial establishments and make a fresh inspection of the Effluent Treatment Plants installed in the said establishments and their working. After inspection, if it was found that the treatment plants were deficient in all respects and the deficiency pointed out earlier still continued, the Board
was further directed that it would give reasonable time to the industries to eliminate the deficiencies. However, the time so given should not extend beyond the deadline set up by the Court. The Board was directed to file its report within fifteen days. The Court further held that if the industries do not obtain the consent of the State Pollution Board for running their units before the fixed time limit they would have to stop functioning thereafter.

Again in M.C. Mehta v. Union of India [1997(2) SCC 411], the Supreme Court was concerned about the discharge of untreated effluents into the river Ganga by tanneries located in Calcutta. According to the Court the scope of the direction issued to the city of Kanpur was enlarged to include various cities located on the banks of the River Ganga.

Explaining the magnitude of the harm caused by the effluents discharged by tanneries and the callous attitude of the concerned authorities over the problem, the Supreme Court said that “It should be remembered that the effluent discharged from a tannery is ten times more noxious when compared with the domestic sewage water which flows into the river from any urban area on its banks.” And noted alarmingly that the authorities who were supposed to check the same were totally apathetic to the problem.

The Court directed relocation of the tanneries to a complex and also directed the pollution control board to examine the possibility of setting up of common effluent treatment plants for the Calcutta tanneries in the four areas and indicate the cost for the same. The Court also directed the Government to acquire land for setting up a tannery complex. In a subsequent hearing the Court felt that the State Government and the Minister concerned were still working at a snail’s pace and directed the Minister in charge to file an affidavit in the Court and directed the State Government to assess the need of the tanneries. In a subsequent order the Court directed the owners of the tanneries to bear the cost of setting up the CETP as well as the cost of relocation. The Court actually spent a lot of time to monitor the progress of the tanneries and to see whether the tanneries could function. However, as there was a total lack of seriousness from the side of the tanners, the Court set a deadline and directed that all the tanneries had to stop working as of that date even if the relocation process is not complete. The State Government was asked to assess the cost of loss caused to the environment by the tanneries and lay down the compensation that had to be recovered from the polluters. The compensation was to be recovered and utilised for restoring the environment.

In Ambuja Petrochemicals v. A.P. Pollution Control Board [AIR 1997 AP 41], one of the industries covered by the Patencheru belt of treatment plants was served with a notice for violating the Water (Prevention and Control of Pollution) Act. The industry replied to the notice. The Board however, not satisfied with the reply of the industry, directed its closure. The same was challenged in the High Court.

The High Court dismissed the petition of the industry observing that under the Act, the Board had a mandate to take action against an erring industry. The High Court could not sit in appeal against the action of the Board considering the expertise of the Board in these aspects. The High Court observed that it was open to the industry to comply with the direction of the Board and make a representation which the Board would consider and if satisfied allow the industry to operate.

One of the aspects to be observed here is that the industry had raised all sorts of pleas including that it was a sick industry etc. which was not appreciated by the High Court.

The problem of effluent treatment is highlighted in the Indian Council for Enviro-Legal Action and others v. Union of India [1998(1) SCALE (SP) 5]. 72 industries are members of Patencheru Environotech Limited (PETL) at Patancheru. These industries send their effluents to the Patancheru plant for treatment. It was noticed that the plant was not functioning properly due to various reasons including the fact that the industries who were discharging effluents were sending effluents which was beyond the capacity of the
PETL. The Court set out parameters and directed that the PETL would not accept any effluent which did not come within those parameters. The Court also held that all those industries, which were exceeding those parameters, had to stop production. This direction was also made applicable to 25 industries who were the members of the CETP at Bollaram.

In *Re Bhavani River - Shakti Sugar Mills Ltd.* [1997(11)SCC 312] the issue was pertaining to pollution of river Bhavani from the effluents discharged by the industry. The Board under Section 33-A of the Act had issued directions, which were aimed at ensuring proper storage of the effluent in lagoons and for proper treatment and disposal of the treated effluent. The Supreme Court held that the violations of pollution law by the industry were serious, and the same was posing a health hazard. The Court directed that the industry be closed and also directed the Board to submit a compliance report within ten days.

**Corporate Manslaughter and Corporate Homicide Act 2007, United Kingdom**

In the United Kingdom, the Corporate Manslaughter and Corporate Homicide Act introduced a new offence, across the UK, for prosecuting companies and other organisations where there has been a gross failing, throughout the organisation, in the management of health and safety measures having fatal consequences.

The Corporate Manslaughter and Corporate Homicide Act 2007 is a landmark in law. For the first time, companies and organisations could be found guilty of corporate manslaughter as a result of serious management failures resulting in a gross breach of the duty of care.

The Act, which came into force on 6 April 2008, clarifies the criminal liabilities of companies, including large organisations, where serious failures on the part of the management regarding caring about their men's health and safety measures that led to fatal consequences.

Prosecutions will be, of the corporate body, and not of the individuals, but the liability of directors, board members or other individuals under health and safety law or general criminal law, will remain unaffected. Nevertheless, the corporate body and individuals can still be prosecuted separately for committing health and safety offences.

Companies and organisations have to keep their health and safety management systems under constant review, particularly the way in which their activities are managed and organised by their senior management.

**PROSECUTION UNDER CORPORATE MANSLAUGHTER AND CORPORATE HOMICIDE ACT 2007**

Cotswold Geotechnical Holdings Ltd., a geological survey company, in February 2011 was fined £385,000 over the death of geologist Alexander Wright under the Corporate Manslaughter and Corporate Homicide Act 2007.

The victim was employed by Cotswold Geotechnical Holdings as a junior geologist, and was taking soil samples from inside a pit, which had been excavated as part of a site survey, when the sides of the pit collapsed crushing him.

‘Under the Corporate Manslaughter and Corporate Homicide Act 2007 an organisation is guilty of corporate manslaughter if the way in which its activities are managed or organised causes a death and amounts to a gross breach of a duty of care to the person who died. A substantial part of the breach must have been in the way activities were organised by senior management.’

Cotswold Geotechnical Holdings Ltd. was found guilty by the Court which imposed a fine of £385,000 over the charges under corporate manslaughter relating to the death of Alexander Wright who had died in the 12.6ft (3.8 metres) deep, unsupported trial pit on September 5, 2008.

This prosecution was the first of its kind under the Corporate Manslaughter and Corporate Homicide Act 2007.
Conclusion

To conclude, laws of a country must expand and evolve in order to satisfy the needs of the fast changing society, and keep abreast with the economic developments taking place. As new situations arise, the law has to evolve in order to meet the challenges posed by such new situations. Law cannot afford to remain stagnant. We have to evolve new principles and lay down new norms which would adequately deal with the new problems arising in a highly industrialized economy.

LESSON ROUND-UP

- Strict liability means liability without fault i.e., without intention or negligence. In other words, the defendant is held liable without fault. Absolute liability for the escape of impounded waters was first established in England during the mid-nineteenth century in the case of Rylands v. Fletcher, (1868) LR 3 330.

- In the Bhopal Gas Disaster case, the Supreme Court of India came out with an over all settlement of claims and awarded the U.S. $470 million to the Government of India on behalf of all Bhopal victims in full and final settlement of all the past, present and future claims arising from the disaster.

- In M.C. Mehta v. Union of India, the Apex Court held that the measure of compensation in the kind of cases must be correlated to the magnitude and capacity of the enterprise because such compensation must have a deterrent effect.

- In the United Kingdom, the Corporate Manslaughter and Corporate Homicide Act introduced a new offence across the UK, for prosecuting companies and other organisations where there has been a gross failing, throughout the organisation, in the management of health and safety measures resulting in fatal consequences.

- Law cannot afford to remain static. We have to evolve new principles and lay down new norms to adequately deal with the new problems arising in a highly industrialized economy.

SELF-TEST QUESTIONS

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

1. Discuss the rule stated by Blackburn, J. (Court of Exchequer) in Rylands v. Fletcher.

2. Discuss briefly the Corporate Manslaughter and Corporate Homicide Act, 2007 of the United Kingdom.

NOTE:

— The study has been prepared with some inputs adopted from the Study Material of National Law School of India (NLSI) University of Bangalore, on Environmental Laws of the MBL Course. The Institute acknowledges the NLSI with thanks.

— Students may refer to the relevant AIR mentioned in the study.
To enable the students in achieving their goal to become successful professionals, Institute has prepared a booklet ‘A Guide to CS Students’ to provide them with the subject specific guidance on different papers and subjects contained in the ICSI curriculum. The booklet is available on ICSI website and students may download it from http://www.icsi.edu/Portals/0/AGUIDETOCSSTUDENTS.pdf

WARNING

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

“27. Suspension and cancellation of examination results or registration

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

Explanation - Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute”.
PROFESSIONAL PROGRAMME
ETHICS, GOVERNANCE AND SUSTAINABILITY
TEST PAPER 1
(This Test Paper is for practice and self study only and not to be sent to the Institute.)
Time allowed: 3 hours Maximum marks: 100

PART A
(Ethics & Governance)
(All Questions are compulsory.)

1. (a) What is Credo? Explain with the help of a case study how ‘credo’/value statements guide companies. (10 marks)

(b) Briefly explain the following:
   (i) CEO/CFO certification in terms of Clause 49 of the Listing Agreement
   (ii) COSO Internal Control Framework
   (iii) Performance Evaluation of Directors as per UK Corporate Governance Code
   (iv) Lead Independent Director
   (v) Shareholder Activism (3 marks each)

2. (a) Explain the term Ethical Dilemma? What steps can be taken to resolve an Ethical Dilemma? (5 marks)

(b) What do you understand by Secretarial Audit as a tool of ensuring good governance and how can it benefit the organisation? (5 marks)

(c) Briefly explain ‘Statement of Independence’ in relation to Independent Directors. Describe how the tenure of Independent Directors has a bearing on their Independence. (5 marks)

OR

2A. (a) What do you understand by Fraud Risk Management? Discuss the role of Company Secretary in Risk Management. (5 marks)

(b) Discuss the role and importance of Institutional Investors in promoting good governance. (5 marks)

(c) Discuss the Clarkson Principle of Stakeholder Management. (5 marks)

3. (a) What do you understand by Board Charter. List out the contents of a Model Board Charter. (5 marks)

(b) Discuss about the role of Secretarial Standards as a roadmap for company secretaries in discharging the governance functions. Briefly explain the highlights of Secretarial Standard -1 (SS-1) issued by the ICSI. (5 marks)

(c) Discuss the corporate governance in Public Sector Enterprises. (5 marks)

4. (a) Board Committees are essential for good management of an organization and to ensure good governance as well. Explain the mandatory Committees under the Companies Act, 2013? (5 marks)
(b) Discuss the role of Nomination and Remuneration Committee in good governance. (5 marks)

(c) The ASX Corporate Governance Council has issued the third edition of governance principles and recommendations. Explain the approach, applicability disclosures required and the structure of Principles and Recommendations. (5 marks)

PART B

(Sustainability)

(All Questions are Compulsory)

5. (a) Your Company is planning to bring out the sustainability report. As a company secretary prepare a note for the Board of Directors highlighting the importance of Sustainability Reporting and the available framework. (5 marks)

(b) The Companies Act 2013 has recommended minimum CSR Expenditure for all specified companies. What is this CSR expenditure and list the activities specified in Schedule VII of the Act. (5 marks)

(c) Write a note on UN Principles for Responsible Investment. (5 marks)

6. (a) Once the activity carried out by any person is hazardous or inherently dangerous, the person carrying on such activity is liable to make good the loss caused to any other person by his activity. Whether in such a case the plea that reasonable care was taken while carrying out such activity is valid? Discuss in the light of decided case laws. (5 marks)

(b) What is the regulatory framework for environment protection in India? (5 marks)

(c) Explain the term ‘Carbon Footprint’. (5 marks)

OR

6A. Write short note on the following:
   (i) Global Reporting Initiative (GRI)
   (ii) Kyoto Protocol
   (iii) CSR Standard - ISO 26000 (5 marks each)