
STUDY MATERIAL

PROFESSIONAL PROGRAMME

**ETHICS, GOVERNANCE
AND
SUSTAINABILITY**

MODULE II
PAPER 6



**THE INSTITUTE OF
Company Secretaries of India**
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

ICSI House, 22, Institutional Area, Lodi Road, New Delhi 110 003
tel 011-4534 1000, 4150 4444 fax +91-11-2462 6727
email info@icsi.edu website www.icsi.edu

© THE INSTITUTE OF COMPANY SECRETARIES OF INDIA

TIMING OF HEADQUARTERS

Monday to Friday

Office Timings – 9.00 A.M. to 5.30 P.M.

Public Dealing Timings

Without financial transactions – 9.30 A.M. to 5.00 P.M.

With financial transactions – 9.30 A.M. to 4.00 P.M.

Phones

41504444, 45341000

Fax

011-24626727

Website

www.icsi.edu

E-mail

info@icsi.edu

Laser Typesetting by AArushi Graphics, Prashant Vihar, New Delhi, and
Printed at Tan Prints/PRN-2509/July 2014

PROFESSIONAL PROGRAMME

ETHICS, GOVERNANCE AND SUSTAINABILITY

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 June, 2014). 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. 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 e-bulletin Student Company Secretary.

SYLLABUS

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
- Board Charter, Meetings and Processes
- Directors' Training and Development
- Performance Evaluation of Board and Directors

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

Recommended Readings and References:

1. Inderjit Dube : Corporate Governance; LexisNexis Butterworths Wadhwa Nagpur
2. Sanjiv Agarwal : Corporate Governance: Concept & Dimensions; Snow white Publications P. Ltd.
3. K R Sampath : Law of Corporate Governance: Principles and Perspective; Snow white Publications P. Ltd.
4. N Balasubramanian : Corporate Governance and Stewardship; Tata McGrawHill
5. H C Mruthyunjaya : Business Ethics and Value System, PHI
6. A C Fernando : Business Ethics – An Indian Perspective
7. ICSI Taxmann : Corporate Governance Beyond Letters
8. Journals
 - (a) ICSI — Chartered Secretary
 - (b) ICSI — Student Company Secretary
9. Guidance Note on Corporate Governance Certificate
10. Companies Act, 2013
11. Rules on Companies Act, 2013
12. Listing Agreement by SEBI

ARRANGEMENT OF STUDY LESSONS

PART A: ETHICS AND GOVERNANCE (70 MARKS)

1. Introduction: Ethics and Governance
2. Ethical Principles in Business
3. Conceptual Framework of Corporate Governance
4. Legislative Framework of Corporate Governance in India
5. Board Effectiveness-Issues and Challenges
6. Board Committees
7. Corporate Governance and Shareholder Rights
8. Corporate Governance and Other Stakeholders
9. Risk Management and Internal Control
10. Corporate Governance in Banks, Insurance and Public Sector Companies
11. Corporate Governance Forums
12. Legislative Framework of Corporate Governance – An International Perspective

PART B: SUSTAINABILITY (30 MARKS)

1. Corporate Social Responsibility
2. Sustainability
3. Corporate Sustainability Reporting Framework
4. Legal Framework, Conventions, Treaties on Environmental and Social Aspects
5. Principles of Absolute Liability

TEST PAPERS

CONTENTS

LESSON 1

INTRODUCTION: ETHICS AND GOVERNANCE

	<i>Page</i>
Introduction	2
Governance through Inner Conscience	2
Ethics in Business	3
The Concept of Business Ethics	3
Corporate Governance Ethics	4
Theories of Ethics	5
Ethical Theories	5
Deontological Theories – Kantian Ethics	5
Teleological Theories	6
Utilitarian Approach	6
Virtue Theory	6
Justice Theory	7
Theory of Egoism	7
Theory of Relativism	8
Scope of Business Ethics	8
Advantages of Business Ethics	10
CONCLUSION	11
LESSON ROUND-UP	11
SELF-TEST QUESTIONS	12

LESSON 2

ETHICAL PRINCIPLES IN BUSINESS

Introduction	14
Organization Structure and Ethics	14
Role of Board of Directors	15
Ethics Programme	15
Best Practices in Ethics Programme	16

	<i>Page</i>
Features of Good Ethics Programme	16
Code of Ethics	17
Code of Conduct	18
Preamble	19
General Moral Imperatives	19
Specific Professional Responsibilities	20
Specific Additional Provisions for Board Members and Management Committee Members	22
Compliance with the Code	22
Credo	23
Ethics Training and Communication	25
Ethics Committee	26
Integrity Pact	27
Concept of whistle-blower	28
Social and Ethical Accounting	30
Ethics Audit	30
Ethical Dilemma	31
CONCLUSION	33
LESSON ROUND-UP	34
SELF-TEST QUESTIONS	35

LESSON 3

CONCEPTUAL FRAMEWORK OF CORPORATE GOVERNANCE

Introduction	38
Definitions of Corporate Governance	38
ICSI Principles of Corporate Governance	39
Need for Corporate Governance	40
Evidence of Corporate Governance from the Arthashastra	41
Corporate Governance Theories	42
Evolution of Corporate Governance	44
Corporate Governance Developments in USA	44
Corporate Governance Developments in UK	44
Developments in India	48
Confederation of Indian Industry (CII) - Desirable Corporate Governance: A Code	48

	<i>Page</i>
Gist of Coverage of CII Desirable Corporate Governance: A Code	51
Kumar Mangalam Birla Committee (2000)	52
Task Force on Corporate Excellence Through Governance	55
Naresh Chandra Committee (2002)	56
N.R. Narayana Murthy Committee (2003)	61
Dr. J J Irani Expert Committee on Company LAW (2005)	64
Corporate Governance Voluntary Guidelines 2009	65
Some of the Provisions Relating to Corporate Governance under Companies Act, 2013	66
Corporate Governance through Listing Agreement	66
Elements of Good Corporate Governance	68
LESSON ROUND UP	70
SELF TEST QUESTIONS	71

Lesson 4

Legislative Framework of Corporate Governance In India

Introduction	74
Board Structure	74
Separation of Roles of Chairman and Chief Executive	76
Meetings of the Board	76
Powers of the Board	77
Board Committees	78
Audit Committees	78
Nomination and Remuneration Committees	78
Stakeholders Relationship Committee	78
Corporate Social Responsibility Committee	79
Disclosure and Transparency	79
1. In Terms of Companies Act, 2013	79
2. In Terms of Various Rules Made Under Companies Act, 2013	81
3. In Terms of Listing Agreement	84
4. Disclosures In Terms of SEBI Regulations	91
CONCLUSION	95
ANNEXURE	95
LESSON ROUND-UP	112
SELF-TEST QUESTIONS	112

LESSON 5

BOARD EFFECTIVENESS - ISSUES AND CHALLENGES

Introduction	114
Segment I - Role of Directors	114
Who are Board of Directors?	115
Types of Board	115
Who are Directors?	116
Governance Functionaries	116
Case Studies	125
Board Composition	132
Segment II - Board Charter	133
Board Processes	134
Board Meetings	134
Good Practices in Convening Board Meetings	134
Provisions Regarding Meetings of the Board	136
Decision Making Process at the Meeting	139
Separate Meetings	142
Directors' Time Commitment	142
Segment III - Responsibilities of Board	143
Corporate Social Responsibility	144
Responsibility towards government	144
Inter-se responsibilities	145
Responsibility for Leadership	145
Policy Governance	145
Relationship between Directors And Executive	146
The Key Difference between Directors And Managers	146
Barriers to Visionary Leadership	148
Segment IV - Training of Directors	148
Performance Review of Board & Individual Director	150
Parameters	151
Performance Evaluation of the Non-Executive Director	152
CONCLUSION	153
LESSON ROUND UP	153
SELF TEST QUESTIONS	154

LESSON 6
BOARD COMMITTEES

Introduction	158
Need and Advantages of Committees Management	158
Enhancing Effectiveness of Committees	159
Membership in Committees	159
Mandatory Committees	160
Audit Committee	160
Nomination and Remuneration Committee	167
The Stakeholders Relationship Committee	169
Corporate Social Responsibility Committee	169
Non-Mandatory Committees	170
Corporate Governance Committee	171
Regulatory, Compliance & Government Affairs Committee	171
Science, Technology & Sustainability Committee	172
Risk Management Committee	173
Other Committees	173
LESSON ROUND UP	174
SELF TEST QUESTIONS	175

LESSON 7
CORPORATE GOVERNANCE AND SHAREHOLDER RIGHTS

Introduction	178
Rights of Shareholders	178
Shareholder rights enshrined in the Companies Act, 2013	180
Challenges in Exercising Shareholders Rights	186
Investor Protection in India	186
Insider Trading	187
Investor Education & Protection Fund	187
Protection of Rights of Minority Shareholders and Related Party Transactions	190
Shareholder activism	195
Investor Relations (IR)	197
Role of Institutional Investors in Corporate Governance	199

	<i>Page</i>
Institutional Investors – Global Trends	201
PRI- Principles for Responsible Investment- An investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact	203
The Code for Responsible Investing in South Africa (CRISA)	205
California Public Employees’ Retirement System	205
Tools Used by Institutional Investors	206
CONCLUSION	208
LESSON ROUND UP	209
SELF TEST QUESTIONS	210

LESSON 8

CORPORATE GOVERNANCE AND OTHER STAKEHOLDERS

Introduction: Stakeholder Concept	212
Recognition of Stakeholder Concept In Law	212
Stakeholder Engagement	213
Stakeholder Analysis	214
Better Stakeholders Engagement Ensures Good Governance	214
Types of Stakeholders	215
The Caux Round Table	215
The Clarkson Principle of Stakeholder Management	219
Governance Paradigm and Stakeholders	219
Whistle Blower Policy	220
Recent Developments	221
The Employees-First Effect	222
Customers	222
Lenders	223
Vendors	223
Government	224
Corporate Governance Voluntary Guidelines 2009	224
National Voluntary Guidelines on Social, Environmental & Economic Responsibilities of Business	225
SEBI - Business Responsibility Report	225
Society	225
Governance Norms for Stakeholders under Companies Act, 2013	226
CONCLUSION	226

	<i>Page</i>
LESSON ROUND UP	227
SELF-TEST QUESTIONS	228

Lesson 9

Risk Management and Internal Control

Introduction	230
Segment I - Risk Management	230
Risk Classification	230
Risk Management Process	232
Advantages of Risk Management	236
Fraud Risk Management	237
Reputation Risk Management	238
Non-Compliance Risk Management	239
Secretarial Audit & Company Secretary in Practice (PCS)	240
Responsibility of Risk Management	241
Role of Company Secretary	242
Segment II- Internal Control System	243
Internal Control Defined	244
COSO Definition of Internal Control	245
Components of Internal Control	246
Relationship of Objectives and Components	247
Components and Principles	247
Role and Responsibilities With Regard to Internal Control	248
CONCLUSION	252
LESSON ROUND UP	253
SELF TEST QUESTIONS	254

LESSON 10

CORPORATE GOVERNANCE IN BANKS, INSURANCE AND PUBLIC SECTOR COMPANIES

Introduction	256
Classification of Banks	256
Regulation of Banks	256
Board Composition	257
Nationalised Banks (Management and Miscellaneous Provisions) Scheme, 1970	258

	<i>Page</i>
Governance in Insurance Companies	259
Corporate Governance in Public Sector Enterprises	263
CONCLUSION	265
LESSON ROUND-UP	265
SELF-TEST QUESTIONS	266

LESSON 11

CORPORATE GOVERNANCE FORUMS

Introduction	268
A. Institute of Company secretaries of India	268
B. National Foundation for Corporate Governance (NFCG)	270
C. Organization for Economic Co-Operation and Development (OECD)	271
D. Global Corporate Governance Forum (GCGF)	272
E. The Institute of Directors (IoD), UK	274
F. Commonwealth Association of Corporate Governance (CACG)	274
G. International Corporate Governance Network (ICGN)	275
H. The European Corporate Governance Institute (ECGI)	276
I. Conference Board	276
J. The Asian Corporate Governance Association (ACGA)	277
K. Corporate Secretaries International Association (CSIA)	277
LESSON ROUND UP	279
SELF TEST QUESTIONS	279

LESSON 12

LEGISLATIVE FRAMEWORK OF CORPORATE GOVERNANCE - AN INTERNATIONAL

Introduction	282
Australia	282
The ASX Corporate Governance Council issued Corporate Governance Principles and Recommendations	283
Singapore	287
Corporate Governance in Singapore	287
South Africa	291
Corporate Governance in South Africa	291
United Kingdom	295

	<i>Page</i>
Corporate Governance in the United Kingdom (UK)	295
Malasiya	298
Malaysian Corporate Governance Code, 2012	298
Contemporary Developments in Corporate Governance – Globally	300
European Commission and legislative framework	300
Corporate Governance framework in European Union	300
European Commission Action Plan – 2012	301
Corporate Governance Codes - Globally	302
LESSON ROUND-UP	302
SELF-TEST QUESTIONS	303

LESSON 13

CORPORATE SOCIAL RESPONSIBILITY

Introduction	306
Meaning and Definitions	306
CSR is not Philanthropy	308
CSR is a contract with society	308
Why CSR at All?	308
Factors Influencing CSR	309
Triple Bottom Line Approach of CSR	310
CSR in INDIA	311
Corporate Social Responsibility Voluntary Guidelines, 2009	311
National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011	314
Corporate Social Responsibility Under The Companies Act, 2013	318
Companies (Corporate Social Responsibility Policy) Rules, 2014	320
Corporate Citizenship - Beyond The Mandate of Law	323
CSR Standard - ISO 26000	324
CSR Assessment	325
CONCLUSION	325
LESSON ROUND-UP	327
SELF-TEST QUESTIONS	327

LESSON 14

SUSTAINABILITY

Introduction	330
Sustainable Development	330
Role of Business in Sustainable Development	331
Sustainability Terminologies	332
What Is Corporate Sustainability?	334
Corporate Sustainability and Corporate Social Responsibility	336
Why is Sustainability an Imperative?	337
Government's Role in improving Sustainability Reporting	337
Kyosei	337
Triple Bottom Line (TBL)	339
CONCLUSION	340
LESSON ROUND-UP	341
SELF-TEST QUESTIONS	341

LESSON 15

CORPORATE SUSTAINABILITY REPORTING FRAMEWORKS

Introduction	344
Key drivers of sustainability reporting	344
Business Responsibility Reporting in India	345
Global Reporting Initiative (GRI)	348
Transition to G4 Guidelines	353
UN Global Compact	354
CSR Reporting Frameworks	356
UN-Principles for Responsible Investment (PRI)	357
Sustainability Indices	359
Benefits Of Sustainability Reporting	361
Challenges In Mainstreaming Sustainability Reporting	361
Contemporary Developments- Integrated Reporting	362
Development of Successful Sustainability Report	362
Sustainability Reporting – Case Studies	363
CONCLUSION	366

	<i>Page</i>
Business Responsibility Reports - Frequently Asked Questions (FAQs)	366
LESSON ROUND-UP	371
SELF-TEST QUESTIONS	371

Lesson 16

LEGAL FRAMEWORK, CONVENTIONS, TREATIES ON ENVIRONMENTAL AND SOCIAL ASPECTS

Introduction	374
1. United Nations Conference on Human Environment	374
2. United Nations Environment Programme	374
3. Brundtland Commission	375
4. United Nations Conference on Environment and Development	375
5. Kyoto Protocol	380
6. Bali Roadmap	381
7. United Nations Conference on Sustainable Development, Rio+20	381
8. International Forest Carbon Initiative	383
9. International Labour Organisation (ILO)	384
Regulatory Framework of Environment Protection in India	384
A Scheme on Labeling of Environment Friendly Products	386
LESSON ROUND-UP	388
SELF-TEST QUESTIONS	389

LESSON 17

PRINCIPLES OF ABSOLUTE LIABILITY

Introduction	392
Rule in Rylands v. Fletcher	392
Applicability of Rylands Doctrine in India	393
Water Pollution	396
Corporate Manslaughter and Corporate Homicide Act 2007, United Kingdom	398
CONCLUSION	398
LESSON ROUND-UP	399
SELF-TEST QUESTIONS	399

TEST PAPERS

Test Paper 1	402
Test Paper 2	404

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

INTRODUCTION

Today, the corporate world as a whole is in the process of acquiring a moral conscience. The new and emerging concepts in management like corporate governance, business ethics and corporate sustainability are some of the expressions through which this emerging ethical instinct in the corporate world is trying to express and embody itself in the corporate life. In this study we examine the concept of ethics and its importance for the business, corporate governance and governance through inner conscience and sustainability.

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. 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 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 sensuous 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 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 judgments 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 to be kept in mind.

4 PP-EGAS

- 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 tradeoffs. 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 State-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 Teleological theories are interested more in duty.

Deontological Theories – Kantian Ethics

Deontological theories of ethics are different from utilitarian theories of ethics. According to Deontological theories, though the consequences of an act are 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 forwards 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

6 PP-EGAS

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 judgments that would provide common acceptable norm for determining social policy and social legislation.

The utilitarian principle states, "an action is right from ethical point of view if and only if they 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 of 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 dedicatedly takes care of its employees is rewarded with equally loyal and dedicated employees.

1. Attracting and retaining talent

People aspire to join organizations that have high ethical values. Such companies are able to attract the best talent. The ethical climate matters a lot to the employees. Ethical organizations create an environment that is trustworthy, making employees willing to rely on company's policies, ability to take decisions and act on those decisions. In such a work environment, employees can expect to be treated with respect, and will have consideration for their colleagues and superiors as well. Thus, company's' policies cultivate teamwork, promote productivity and support employee-growth.

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

2. Investor Loyalty

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

3. Customer satisfaction

Customer satisfaction is a vital factor of a successful business strategy. Repeated purchases/orders and an enduring relationship with mutual respect is essential for the success of the company. The name of a company should evoke trust and respect among customers for enduring success. This is achieved by a company only

when it adopts ethical practices. When a company with a belief in high ethical values is perceived as such, the crisis or mishaps along the way is tolerated by the customers as minor aberrations. Such companies are also guided by their ethics to survive a critical situation. Preferred values are identified and it is ensured that organizational behavior is aligned to those values. An organization with a strong ethical environment places its customers' interests as foremost. Ethical conduct towards customers builds a strong competitive position for the company. It promotes a strong public image too.

4. Regulators

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

Regulators eye companies functioning ethically as responsible citizens. The regulator need not always monitor the functioning of the ethically sound company. Any organisation that acts within the confines of business ethics not only earns profit but also gains reputation publicly.

To summarise, companies that are responsive to employees' needs have lower turnover in staff.

- Shareholders invest their money into a company and expect a certain level of return from that money in the form of dividends and/or capital growth.
- Customers pay for goods, give their loyalty and enhance a company's reputation in return for goods or services that meet their needs.
- Employees provide their time, skills and energy in return for salary, bonus, career progression and experience.

CONCLUSION

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

Corporate Ethics is much needed to stress the importance of sustainability, social development, stakeholders and consumers satisfaction. It is an orientation to provide a valuable service instead of displaying more orientation for profits. Ethics, point out what is good and what is bad and also what is right or wrong. It brings to the notice of the business community the importance of honesty, sincerity and fairness which makes them alert and socially conscious. It reconciles conflicting interest of various sections of the society such as workers, shareholders, consumers, distributors, suppliers, competitors and government and thus, expedites 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
- Concept of Whistle-Blower
- Social and Ethical Accounting
- 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 organization values and organization climate on ethics; the role of Board of Directors in 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 not only on the basis of what the employees learned from their own background but also on the basis of what they learn from the Organization culture and others in the organisation.

Organisation culture comprises of the attitudes, experiences, beliefs and values of an organization. It can be defined as the specific collection of values and norms that are shared by people and groups in an organization and that control the way people interact with each other, within and outside the organization. An important component of corporate culture is the ethical climate. The ethical climate of an organization is a shared set of understandings 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. It is a function of many factors including corporate policies on ethics, top management's leadership on ethical issues, industry culture, etc.

The ethical tendency or climate of organizations is set at the top. What top managers do, the culture they establish and reinforce, makes a huge difference in the way employees act in the organization, when ethical dilemmas are faced. When the ethical climate is unclear or negative, ethical dilemmas often result in unethical behavior.

Organizations have ethics programme as a way of minimizing the risk of ethical misconduct or wrong doing by employees. These programmes consist of policies, processes, education and training initiatives that explain the company's business ethics. These programmes 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 little authority is delegated to 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 or 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 with 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 is the difficulty they have in responding quickly to changes in policy and procedures established by top management. In addition, independent profit centers within a decentralized organization may deviate from organizational objectives.

Role of Board of Directors

The board of directors holds the ultimate responsibility for their firm's success or failure, as well as for ethics of their actions. 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 and an ethical decision making framework.

The independent perspective and judgment of independent directors can be helpful in determining a company's approach towards ethical issues and stakeholder 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 ethics issues;
- Designation of an officer to oversee ethics and 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 ethics 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 a code of ethics like, 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, that 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 usually specifies acceptable or unacceptable types of behavior. 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 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 unethical conduct in the workplace.
- Every publicly listed corporation should consider establishing a regular review system to ensure that the code is dynamic and 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 or 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 for them to survive and to be successful (b) "how they were doing" at that point in time.

Features of Good Ethics Programme

The following factors indicate the success of an ethics programme:

- **Leadership** means 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 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 employees, the most important ethical issue is how the organization treats them and their co-workers.
- **Openness** means that people can talk openly about ethics and values, and that ethics and values are integrated into business decision-making.
- **Just rewards** say that ethical behaviour is fairly rewarded. This has greater influence on the effectiveness of an ethics programme than the perception that unethical behaviour is punished.
- **Value-driven** means that an ethical and compliance programme is value-driven. This has the most positive effect on ethics and compliance programme and results in:
 - lower observed unethical conduct;
 - stronger employee commitment;
 - a stronger belief that it is acceptable to deliver bad news to 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 fair and unfair arise frequently. In order to deal with these issues, managers need some guidelines. Organisations, both business and non-business formulate such 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, insider trading, misuse of funds. With globalisation of business, more and more companies are developing code of ethics. 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 'dos' 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 code 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 will be implementing the code. Legal staff should also be called on to 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" shall mean 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 Regulation S-K 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 code as an exhibit to the annual report, post the code on the company's website, or agree to provide a copy of the code 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 is implemented and effective. Codes of ethics are not easily created from boilerplate.

Ideally, the development of a code is a process in which Boards and senior management actively debate and decide core values, roles, responsibilities, expectations, and behavioural standards

Thus, code of ethics outlines a set of fundamental principles which could be used both as the basis for operational requirements (things one must do), and operational prohibitions (things one must not do). It is based on a set of core principles and values and is not designed for convenience. The employees subject 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

Code of conduct or what is popularly known as Code of Business Conduct contains standards of business conduct that must guide actions of the Board 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 of 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;
- Maintenance of confidentiality;
- Collection of information from legitimate sources only;
- Safety at workplace;
- Maintaining and Managing Records;
- Free and Fair competition;
- Disciplinary actions.

Model Code of Business Conduct & Ethics

Preamble

Commitment to ethical professional conduct is a MUST for every employee of the company in all of its businesses/units/subsidiaries. This code, consisting of imperatives formulated as statements of personal responsibility, identifies the elements of such a commitment. It contains many, but not all issues, employees are likely to face.

The code is intended to serve as a basis for ethical decision-making in the conduct of professional work. It may also serve as a basis for judging the merit of a formal complaint pertaining to violation of professional ethical standards.

It is understood that some words and phrases in a code of ethics and conduct document are subject to varying interpretations and that any ethical principle may conflict with other ethical principles in specific situations. Questions related to ethical conflicts can best be answered by thoughtful consideration of fundamental principles rather than reliance on detailed regulations. In case of conflict, the decision of the Board shall be final.

Applicability

This code is applicable to the Board Members and all employees in and above Officers level (hereinafter collectively referred to as “Employee(s)”).

All employees must read and understand this code and ensure to abide by it in their day-to-day activities.

General Moral Imperatives

Contribute to society and human well-being

This principle concerning the quality of life of all people affirms an obligation to protect fundamental human rights and to respect the diversity of all cultures. We must attempt to ensure that the products of our efforts will be used in socially responsible ways, will meet social needs and will avoid harmful effects to health and welfare of others.

In addition to a safe social environment, human well-being includes a safe natural environment. Therefore, all of us, who are accountable for the design, development, manufacture and promotion of company’s products, must be alert to, and make others aware of, any potential damage to the local or global environment.

Avoid harm to others

“Harm” means injury or negative consequences, such as loss of property, property damage or unwanted health and environmental impacts. This principle prohibits use of men, material and technology in ways that result in harm to our consumers, employees and the general public.

Well-intended actions, including those that accomplish assigned duties, may lead to harm unexpectedly. In such an event, the responsible person or persons are obligated to undo or mitigate the negative consequences as much as possible.

Be honest and trustworthy

Honesty is an essential component of trust. Without trust an organisation cannot function effectively. All of us are expected not to make deliberately false or deceptive claims about our products/systems, but instead provide full disclosure of all pertinent limitations and problems.

Be fair and take action not to discriminate

The values of equality, tolerance, respect for others, and the principles of equal justice govern this imperative.

Discrimination on the basis of race, sex, religion, age, disability, national origin, or other such factors is an explicit violation of this code.

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, effective-ness 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 compe-tence, 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 competes with the business of Company.
 - *Consultancy/Business/Employment* : Engaging in any activity (be it in the nature of providing consultancy service, carrying on business, accepting employment) which is likely to interfere or conflict with our duties/responsibilities towards the Company. We should not invest or associate ourselves in any other manner with any supplier, service provider or customer of the Company.
 - *Use of Official position for our personal gains* : We should not use our official position for our personal gains.

Compliance with the Code

As employees of the Company, we will uphold and promote the principles of this code

The future of the organisation depends on both technical and ethical excellence. Not only is it important for employees to adhere to the principles expressed in this Code, each employee should encourage and support adherence to the code by other employees.

Treat violations of this code as inconsistent association with the organisation

Adherence of professionals to a code of ethics is largely a voluntary matter. However, if any of us do not follow this code by engaging in process misconduct, the matter would be reviewed by the Board and its decision shall be final. The Company reserves the right to take appropriate action against the guilty employee.

Miscellaneous

Continual updating of code

This code is subject to continuous review and updating 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

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 believe that its Credo is a blueprint for long-term growth and sustainability that's as relevant today as when it was written.

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 it's 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 Tylenon-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 nation-wide 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, and 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 are 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, and 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:

28 PP-EGAS

- 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.

CONCEPT OF WHISTLE-BLOWER

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. It is in this context whistleblowers are often protected under law from employer retaliation. In India, Revised Clause 49 of the equity Listing agreement provides as under with regard to Whistle Blower policy:

Whistle Blower Policy

1. The company shall establish a vigil mechanism for directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy.

2. 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 Chairman of the Audit Committee in exceptional cases.
3. The details of establishment of such mechanism shall be disclosed by the company on its website and in the Board's report

This has been made a mandatory requirement for all the listed company with effect from October 01, 2014. The company 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. The audit committee is responsible to review its functioning, and a disclosure be made in the Annual Report about the Whistle Blower policy and affirmation that no personnel has been denied access to the audit committee.

ICSI Recommendations to strengthen Corporate Governance Framework recommends – adoption of Whistle Blower Policy should be made mandatory, to begin with, for listed companies. A model policy in this regard may be specified covering important clauses that protect employees' interests.

Corporate Governance Voluntary Guidelines, 2009 suggest for Institution of Mechanism for Whistle Blowing

- I. 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.
- II. 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.

ENRON WHISTLE BLOWER

Enron was 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 Nabaska 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), fibre 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.

It became clear that Enron was facing serious financial problems with discussion over a takeover or bankruptcy (*The Economist*, 1 November 2001). Towards the end of October 2001, Moody's credit rating agency cut Enron's rating to barely above that of junk bonds.

Most stakeholders suffered considerably: shareholders saw the value of their investments vaporise almost completely, thousands of employees lost their jobs and creditors lost billions of dollars.

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 of 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.

UNDERSTANDING ETHICAL DILEMMA

You are a senior manager in a major firm of investment managers.

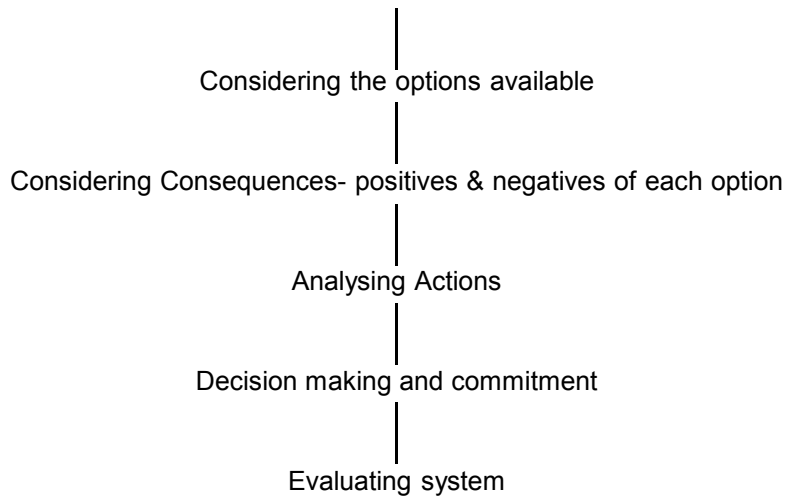
Your employer is an international firm with a publicly stated commitment to the highest standards of ethical behaviour. The company is making losses and is due to make a very important presentation to a major corporate client, and if the deal falls through it would turn around the company. Management 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 judgment 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.

Steps to Resolving an Ethical Dilemma



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 risks that the competitors 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.
- Organisation 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
- Clause 49 of the Listing Agreement requires that - 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 under clause 49 of Listing Agreement.
- An ethical dilemma involves a situation that makes a person question what is the 'right' or 'wrong' thing

Lesson 3

Conceptual Framework of Corporate Governance

LESSON OUTLINE

- Definitions of Corporate Governance
- ICSI Principles of Corporate Governance
- Need for Corporate Governance
- Theories of Corporate Governance
- Evolution and Development of Corporate Governance
- 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 Concept of Corporate Governance, to apprise them 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. This lesson also highlights the evolution of Corporate Governance.

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

– Mervyn King S.C.

INTRODUCTION

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.

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.

<p>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.</p>	<p>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 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</p>
---	--

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 is 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)

<p>OECD “A system by which business Corporations are directed and controlled”</p>	<p>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.</p>
--	--

<p>Cadbury Committee, U.K “(It is) the system by which companies are directed and controlled”.</p>	<p>Corporate Governance is a system of structuring, operating and controlling a company with the following specific aims :</p> <ul style="list-style-type: none"> (i) Fulfilling long-term strategic goals of owners; (ii) Taking care of the interests of employees;
---	---

	<ul style="list-style-type: none"> (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.
--	--

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

**Confederation of Indian Industry (CII) –
Desirable Corporate Governance Code (1998)**

“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.”

**Report of N.R. Narayana Murthy Committee on Corporate
Governance constituted by SEBI (2003)**

“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
ICSI Principles of Corporate Governance**

ICSI Principles of Corporate Governance

1. Sustainable development of all stakeholders	Ensure growth of all individuals associated with or affected by the enterprise on sustainable basis.
2. Effective management and distribution of wealth	Ensure that enterprise creates maximum wealth and judiciously uses the wealth so created for providing maximum benefits to all stakeholders and enhancing its wealth creation capabilities to maintain sustainability.
3. Discharge of social responsibility	Ensure that enterprise is acceptable to the society in which it is functioning.
4. Application of best management practices	Ensure excellence in functioning of enterprise and optimum creation of wealth on sustainable basis.

5 Compliance of law in letter and spirit	Ensure value enhancement for all stakeholders guaranteed by the law for maintaining socio-economic balance.
6. Adherence to ethical standards	Ensure integrity, transparency, independence and accountability in dealings with all stakeholders.

NEED FOR CORPORATE GOVERNANCE

Corporate Governance is integral to the existence of the company.

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

Corporate Performance: Improved governance structures and processes help 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.

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 & 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 upto 40 percent for shares in companies with superior corporate governance practices.

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

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

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.

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.

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

Accountability: Investor relations' is essential part of good corporate governance. Investors have directly/indirectly entrusted management of the company for the creating 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 where Boards cannot ignore their accountability to these stakeholders.

EVIDENCE OF CORPORATE GOVERNANCE FROM THE ARTHASHASTRA

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. If rulers are responsive, accountable, removable, recallable, there is stability. If not there is instability. These tenets hold good even today.

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

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.”

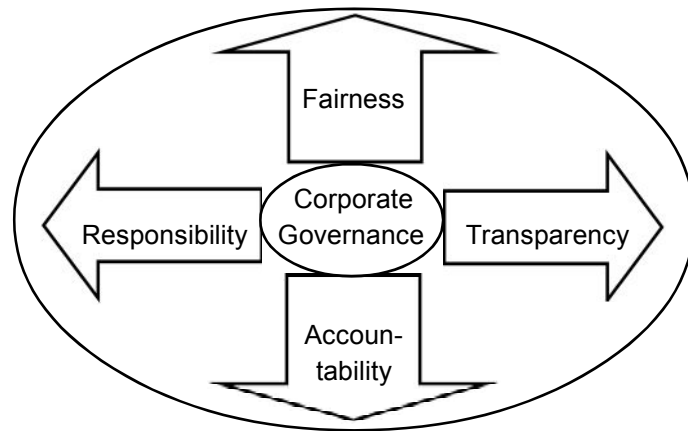
Kautilya has emphasized on the imperatives of the king and his counselors acting in concert. Cohesion is key to the successful functioning of a board and the company it directs. A board that contributes constructively to sustainable success but does not compromise on the integrity and independence of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

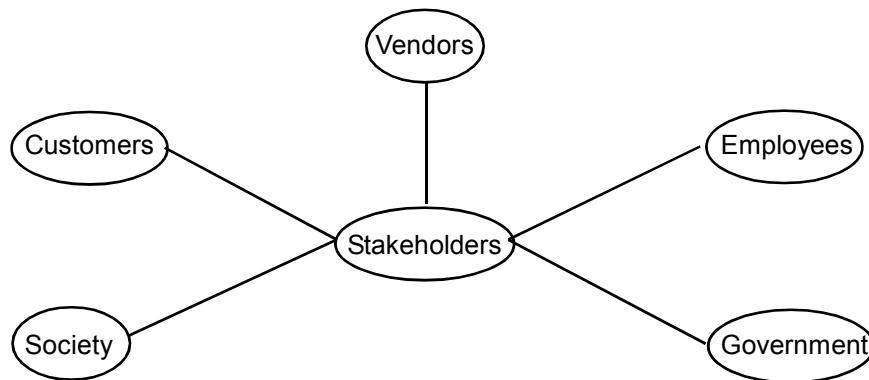
Balancing the interests of the various stakeholders who is again at the core of good corporate governance, is highlighted in the Arthashastra and the other ancient texts. There is no prescription in the scriptures that the interests of only selected few need to be the concern of the king. This generic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

Corporate Governance is managing, monitoring and overseeing various corporate systems in such a manner

that corporate reliability, reputation are not put at stake. Corporate Governance pillars on transparency and fairness in action satisfying accountability and responsibility towards the stakeholders.



The long term performance of a corporate is judged by a wide constituency of stakeholders. Various stakeholders affected by the governance practices of the company:



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

Agency Theory

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

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

In modern corporations, the shareholdings are widely spread. The management (the agent) directly or indirectly selected by the shareholders (the Principals), pursue the objectives set out by the shareholders. The main thrust of the Agency Theory is that the actions of the management differ from those required by the shareholders to maximize their return. The principals who are widely scattered may not be able to counter this in the absence of proper systems in place as regards timely disclosures, monitoring and oversight. Corporate Governance puts in place such systems of oversight.

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.

Stakeholder Theory

According to this theory, the company is seen as an input-output model and all the interest groups which include creditors, employees, customers, suppliers, local-community and the government are to be considered. From their point of view, a corporation exists for them and not the shareholders alone.

The different stakeholders also have a self interest. The interests of these different stakeholders are at times conflicting. The managers and the corporation are responsible to mediate between these different stakeholders interest. The stake holders have solidarity with each other. This theory assumes that stakeholders are capable and willing to negotiate and bargain with one another. This results in long term self interest.

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

Stewardship Theory

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

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

EVOLUTION OF CORPORATE GOVERNANCE

Corporate Governance Developments in USA

Years	Developments
1977 The Foreign Corrupt Practices Act	Provides for specific provisions regarding establishment, maintenance and review of systems of internal control.
1979 US Securities Exchange Commission	Prescribed mandatory reporting on internal financial controls.
1985 Treadway commission	Emphasized the need of putting in place a proper control environment, desirability of constituting independent boards and its committees and objective internal audit function. As a consequence, the Committee of Sponsoring Organisations (COSO) took birth.
1992 COSO issued Internal Control – Integrated Framework.	The Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued Internal Control – Integrated Framework. It is a framework “to help businesses and other entities assess and enhance their internal control systems”.
2002 Sarbanes – Oxley Act	The Act made fundamental changes in virtually every aspect of corporate governance in general and auditor independence, conflict of interests, corporate responsibility, enhanced financial disclosures and severe penalties for wilful default by managers and auditors, in particular.
The Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010	Vote on Executive Pay and Golden Parachutes: Gives shareholders a say on pay with the right to a non-binding (advisory) vote on executive pay and golden parachutes (acquisitions). This gives shareholders a powerful opportunity to hold accountable executives of the companies they own, and a chance to disapprove where they see the kind of misguided incentive schemes that threatened individual companies and in turn the broader economy.

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.

<p>1995 Greenbury Report</p>	<p>Confederation of British Industry constituted a group under the chairmanship of Sir Richard Greenbury to make recommendations on Directors' Remuneration. Major Findings:</p> <p>Constitution of a Remuneration Committee comprising of Non Executive Directors</p> <p>Responsibility of this committee in determining the remuneration of CEO and executive directors</p> <p>Responsibility of the committee in determining the remuneration policy.</p> <p>Level of disclosure to shareholders regarding the remuneration of directors'.</p> <p>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.</p>
<p>1998 Hampel Report</p>	<p>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.</p> <p>Recommendations of this Report and further consultations by the London Stock Exchange became the Combined Code on Corporate Governance. – The original combined Code.</p>
<p>1999 Turnbull Report</p>	<p>The report informs directors of their obligations under the Combined Code with regard to keeping good "internal controls" in their companies, or having good audits and checks to ensure the quality of financial reporting and catch any fraud before it becomes a problem. Turnbull Committee published "Internal Control Guidance for Directors on Combined Code". Revised version was issued in 2004. Further Revised "Internal Control Guidance for Directors on Combined Code" was issued in October, 2005.</p>
<p>2001 Myners: Review of Institutional Investment</p>	<p>Paul Myners 'Institutional Investment in the UK: A Review' published in 2001, was commissioned by the Government, 'to consider whether there were factors distorting the investment decision-making of institutions.' The analysis contained in the Report pointed to a number of problems with the existing structures used by the various types of institutional investors to make investment decisions.</p>
<p>2003 Revised Combined Code</p>	<p>Recommendations of Higgs Report, Smith Report & Tyson Report relating to role and effectiveness of non-executive directors, audit committee and recruitment & development of non-executive directors, provided recommendations for the revised combined code.</p>
<p>2008 Combined Code on Corporate Governance</p>	<p>The Combined Code on Corporate Governance 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</p>

	to report on how they have applied the Combined Code in their annual report and accounts.
2009 Walker Review of Corporate Governance of UK Banking Industry	<p>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:</p> <p>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.</p>
2012 UK Corporate Governance Code (Revised)	<p>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.</p> <p>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”.</p> <p>*FTSE - FTSE is an independent index company jointly owned by The Financial Times and the London Stock Exchange.</p>
2012 The UK Stewardship Code (Revised)	<p>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.</p> <p>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.</p>

Financial Reporting Council is always be willing to revise the Codes when it is necessary and it is currently considering possible changes to the UK Corporate Governance Code for 2014. One area of focus for companies needs to be succession planning, the quality of which has been highlighted as a cause for concern in many contexts during 2013.

The FRC is considering whether to make changes to the Code in 2014 in relation to risk management and reporting; remuneration and the work of the audit committees as a consequence of major reviews carried out by the Sharman Panel, the Government and the Competition Commission respectively, and is consulting on its proposals. It seems likely that further regulatory requirements making tendering and auditor rotation mandatory will be agreed at European level, where negotiations on the Audit Directive and Regulation appear to be reaching a conclusion.

DEVELOPMENTS IN INDIA

The initiatives taken by Government in 1991, aimed at economic liberalization 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.

Confederation of Indian Industry (CII) - Desirable Corporate Governance: A Code

CII took a special initiative on Corporate Governance, the first institution initiative in Indian Industry. The objective was to develop and promote a code for Corporate Governance to be adopted and followed by Indian companies, whether in the Private Sector, the Public Sector, Banks or Financial Institutions, all of which are corporate entities. The final draft of the said Code was widely circulated in 1997. In April 1998, the Code was released. It was called Desirable Corporate Governance: A Code. A brief summary of the Desirable Corporate Governance Code is reproduced hereunder:

Recommendation I

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

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

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

Recommendation III

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

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

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

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 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

- 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 its 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

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

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

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

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

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

Recommendation XIV

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

- 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

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.

Gist of Coverage of CII Desirable Corporate Governance: A Code

Recommendation I	Frequency of Board meetings
Recommendation II	Board Composition
Recommendation III	No. of directorships
Recommendation IV	Role, Responsibilities, Qualifications of Non-executive Directors
Recommendation V	Remuneration of non-executive directors

Recommendation VI	Disclosure of attendance record for reappointment
Recommendation VII	Key information to the Board
Recommendation VIII	Audit Committee
Recommendation IX	Disclosure on shareholder information
Recommendation X	Consolidated Accounts
Recommendation XI	Compliance certificate
Recommendation XII	Disclosure relating to Global Depository Receipts(GDR)
Recommendation XIII	Funding
Recommendation XIV	Nominee Director
Recommendation XV	Disclosure of Ratings
Recommendation XVI	Default on fixed deposits by company

KUMAR MANGALAM BIRLA COMMITTEE (2000)

The Securities and Exchange Board of India (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 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 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

For all listed companies as well as public limited companies whose paid-up capital and free reserves exceeds 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 firms 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 Rs.10 crore and above, or turnover of Rs.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 Rs.10 crore and above, or turnover of Rs.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 Rs.10 crore and above or turnover of Rs.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 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 that 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 Rs.10 crore and above, or turnover of Rs.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 Rs.10 crore and above, or turnover of Rs.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 includes 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.

N.R. NARAYANA MURTHY COMMITTEE (2003)

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 applicable) and with the approval of shareholders.
- **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) Stake-holder’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.

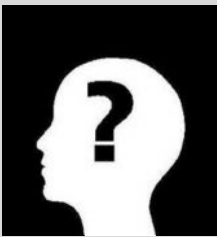
Law should provide for voting through electronic mode. AGMs may be held at a place other than place of registered office (in India), provided at least 10% members in number reside at such place.

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 Officer 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 Voluntary Guidelines 2009

- Good corporate governance practices enhance companies’ value and stakeholders’ trust resulting into robust development of capital market, the economy and also help in the evolution of a vibrant and constructive shareholders’ activism.

- Considering the above, the Ministry of Corporate Affairs issued Corporate Governance Voluntary Guidelines, 2009 after duly examining committee reports and suggestions received from various stakeholders on issues related to corporate governance.
- These guidelines provide a set of good practices which may be voluntarily adopted by the public companies and private companies, particularly the bigger ones. These guidelines are not substitute for or addition to the existing laws but is recommendatory in nature.
- **‘Comply or Explain’ Basis**
- While the guidelines are expected to be adopted by more and more corporates, there may be genuine reasons for some companies for not being able to adopt them. In such a case it is expected that such companies should inform their shareholders about the reasons for not adopting these guidelines either fully or partially.



Comparatively analyze Desirable Code of Corporate Governance & Naresh Chandra Committee report with regard to Board composition and remuneration of non-executive directors.

Some of the Provisions Relating to 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. Mandatory provisions related to independent directors, woman director, Key Managerial Personnel and Performance Evaluation of the Board.
2. 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 etc.
3. Stricter yet forward-looking procedural requirements for Secretarial compliances and ICSI Secretarial Standards made mandatory.
4. Enhanced scope of Related Party Transactions and introduction of concept of arm's length pricing.
5. Enhanced restrictions on appointment and rotation of Auditors. Separation of role of Chairperson and Chief Executive Officer.
6. Introduction of mandatory provisions regarding Whistle Blower Policy, Audit Committee, Nomination and Remuneration Committee, Stakeholders Relationship Committee, and Corporate Social Responsibility Committee.

Corporate Governance through Listing Agreement

SEBI appointed the Committee on Corporate Governance on May 7, 1999 under the Chairmanship of Shri Kumar Mangalam Birla, to promote and raise the standards of Corporate Governance. The Committee's primary aim was to:

- (i) to suggest suitable amendments to the listing agreement executed by the stock exchanges with the

companies and any other measures to improve the standards of corporate governance in the listed companies;

- (ii) to draft a code of corporate best practices; and
- (iii) to suggest safeguards to be instituted within the companies to deal with insider information and insider trading.

Key constituents of corporate governance identified by the committee are:

- the shareholders;
- the Board of Directors; and
- the management

The report also identified key constituents' roles, responsibilities and rights in the context of good corporate governance. It recognized three major aspects of corporate governance.

Accountability

Transparency

Equal treatment to all stakeholders

Considering the recommendations of the report SEBI incorporated Clause 49 to the listing agreement in February 2000. SEBI, as part of its endeavour to improve the standards of corporate governance in line with the needs of a dynamic market has amended the Clause 49 from time to time.

SEBI vide its circular No. CIR/CFD/POLICY CELL /2/2014 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. The new norms are aligned with the Companies Act, 2013 and are aimed to encourage companies to adopt best practices on corporate governance. The new norms are applicable from 1st October, 2014. The highlights of the revised Clause 49 are as follows:

- Exclusion of nominee Director from the definition of Independent Director.
- At least one woman director on the Board of the company.
- Compulsory whistle blower mechanism.
- Expanded role of Audit Committee.
- Prohibition of stock options to Independent Directors.
- Separate meeting of Independent Directors.
- Constitution of Stakeholders Relationship Committee.
- Enhanced disclosure of remuneration policies.
- Performance evaluation of Independent Directors and the Board of Directors.
- Prior approval of Audit Committee for all material Related Party Transactions (RPTs)
- Approval of all material RPTs by shareholders through special resolution with related parties abstaining from voting.
- Mandatory constitution of Nomination and Remuneration Committee. Chairman of the said committees shall be independent.
- The maximum number of Boards an independent director can serve on listed companies be restricted to 7 and 3 in case the person is serving as a whole time director in a listed company.

- To restrict the total tenure of an Independent Director to 2 terms of 5 years. However, if a person who has already served as an Independent Director for 5 years or more in a listed company as on the date on which the amendment to Listing Agreement becomes effective, he shall be eligible for appointment for one more term of 5 years only.
- The scope of the definition of RPT has been widened to include elements of Companies Act and Accounting Standards.

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 on going 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>

Lesson 4

Legislative Framework of Corporate Governance In India

LESSON OUTLINE

- Board Structure
- Separation of Roles of Chairman and Chief Executive
- Board Meeting
- Board Powers
- Board Committees
- Disclosure and Transparency provision under the:
 - Companies Act, 2013
 - Listing Agreement
 - SEBI Regulations
- Conclusion
- Annexure
- Lesson Round-Up
- Self Test Questions

LEARNING OBJECTIVES

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

Legislative aspects pertaining to Board Structure, Composition, Board Meetings, Powers of the Board, Committees, Independent Directors, Transparency and Disclosure highlighting the relevant provisions of Companies Act, listing agreement and SEBI guidelines are discussed in the study to equip the student to understand the main legislative components of Corporate Governance in India.

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

– Laisenia Qarase

INTRODUCTION

The heart of corporate governance is transparency, disclosure, accountability and integrity. Legal and regulatory framework of corporate governance in India is mainly covered under the SEBI guidelines, Listing Agreement and Companies Act 2013; 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 Anti-Money Laundering Laws, etc. seeks to ensure good governance practices among the corporates.

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. Corporate governance is not just a legal concept, it is a governance concept, and it is something which has to come from within. However, one can not have abstract concepts applicable to corporates at large and there lies the need for a legislative framework.

In Indian context, there is no single apex regulatory body which can be said to be the regulator of corporates but there exists a coordination mechanism among various functional regulators. For example, in India, we have different regulators for the following –

- Corporates (MCA)
- Capital Market and Stock Exchanges (SEBI)
- Money Market and Banking (RBI)
- Insurance – Life and Non life (IRDA)
- Communication (TRAI)
- Foreign business (FIPB/SIA)
- Imports and Exports (FEMA, DGFT)
- Intermediaries, Banking Companies and Insurance business (FIU-India)
- Listed companies, Stock brokers (Stock Exchanges)
- Professions (Professional Institutes like ICSI, ICAI, ICAI (CMA) etc.)

The success of regulation rests on the intention and integrity of the regulator and the regulated.

A common law system operates in India. Entities are incorporated as companies in terms of the Companies Act, 2013. The Companies Act is administered by the Ministry of Corporate Affairs.

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 revised Listing Agreement of SEBI.

In this study lesson, we will cover the corporate governance norms covered in the Listing Agreement, SEBI Regulations and the Companies Act, 2013.

BOARD STRUCTURE

Size

The Board structure in India is unitary. Section 149 (1) of the Companies Act, 2013 contains provisions regarding the composition of board of directors. It stipulates the minimum number of director as three in case of public company, two in case of private company and one in case of One Person Company. The maximum number of directors stipulated is 15. However, a company may appoint more than 15 directors after passing a special resolution in General Meeting. It may be noted that approval of Central Government is not required

The Listing Agreement does not stipulate on the size of the board.

Composition

Independent Director

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

With respect to the minimum number of Independent directors, 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.

Provided that in case of companies covered under this rule shall appoint a higher number of independent directors as required due to composition of its audit committee. Further, a company belonging to any class of companies for which a higher number of independent directors has been stipulated in a law for the time being in force shall comply with the requirements stipulated in such law.

Woman Director

Proviso 2 to Section 149 provides that such class or classes of companies as may be prescribed in Rules shall have at least one woman director.

With regard to this, Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014 prescribes that the following class of companies shall have at least one woman director:

- Every Listed Company;
- Every other public Company having:
 - Paid-up capital of 100 crore rupees or more;or
 - Turnover of 300 crore rupees or more

Resident Director

Third proviso to Section 149 provides that 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.

Detailed provisions related to Directors are discussed in Lesson Board Effectiveness-Issues and Challenges.

Clause 49(II) (A) of the Listing Agreement contains provisions related to the composition Board of Directors. It provides that 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.

Clause 49 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 the company 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 Chairman is a promoter of the company 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.

Number of Directorship

Section 165 stipulates that a person cannot hold office at the same time as director (including any alternate directorship) in more than 20 companies. Provided that the maximum number of public companies in which a person can be appointed as a director shall not exceed ten.

For reckoning the limit of public companies in which a person can be appointed as director, directorship in private companies that are either holding or subsidiary company of a public company shall be included.

The members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as directors.

Clause 49 of the Listing Agreement 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, every director shall inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

Clause 49 also provides that a person shall not serve as an independent director in more than seven listed companies. 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.

SEPARATION OF ROLES OF CHAIRMAN AND CHIEF EXECUTIVE

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

- (a) The Articles of such a company provide otherwise; or
- (b) The company does not carry multiple business

Separation of roles is instrumental in determining the composition of the Board in terms of Listing Agreement, depending upon executive or non executive Chairman.

MEETINGS OF THE BOARD

Section 173 of the Act deals with Meetings of the Board and Section 174 deals with quorum.

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.

The Act 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.

One third of total strength or two directors, whichever is higher, shall be the quorum for a meeting. For the purpose of determining the quorum, the participation by a director through Video Conferencing or other audio visual means shall also be counted.

Clause 49 of the Listing Agreement provides that the Board shall meet at least four times a year, with a maximum time gap of one hundred and twenty days between any two meetings.

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.

Section 179 of the Act deals with the powers of the board; all powers to do such acts and things for which the company is authorized is vested with board of directors. But the board can act or do the things for which powers are vested with them and not with general meeting. The following (section 179(3) and Rule 8) powers of the Board of directors shall be exercised only 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 resolution may also stipulate the conditions of such sale and lease, 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 also having no knowledge of limit imposed had been exceeded Powers of the Board are not spelt out in Listing Agreement. However, it provides for the responsibilities and functions of the board.

BOARD COMMITTEES

Audit Committees

Section 177 of the Companies Act, 2013 has enlarged the responsibilities of auditors to include monitoring of auditors' independence, evaluation 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. The members must be able to understand financial statements and have a majority of Independent Directors. Large companies must mandatorily have professional internal auditors. Further, in case of Listed Companies, their compliance shall be in accordance with the Corporate Governance provisions enshrined in Clause 49 of the Listing Agreement.

Nomination and Remuneration Committees

The Nomination and Remuneration Committee helps the Board of Directors in the preparations relating to the election of members of the Board of Directors, handling matters within its scope of responsibility that relate to the conditions of employment and remuneration of senior management, to management's and personnel's remuneration and incentive schemes. The responsibilities of the Remuneration and Nomination Committee are defined in its policy document. Section 178 of the Act deals with provisions related to the aforementioned committee. Clause 49 of the Listing agreement also provides for mandatory constitution of Nomination and Remuneration Committee.

Stakeholders Relationship Committee

Section 178(5) of the Companies Act, 2013 provides for constitution of the Stakeholders Relationship Committee.

Further, under Listing Agreement, 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. Clause 49 (VIII) (E) of the Listing Agreement provides that Stakeholders Relationship Committee, under the Chairmanship of non-executive director shall be constituted to look into and redress the grievances of shareholders, debenture holders and other security holders.

Corporate Social Responsibility Committee

Section 135 of the Companies Act, 2013 provides that companies specified in the said section shall constitute a Corporate Social Responsibility Committee (CSR Committee) of the Board. Further Listing Agreement also mandates the constitution of CSR committees for certain companies.

Apart from the above mandatory committees, 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 of the company. The detailed provisions regarding various committees under Companies Act and Listing Agreement are dealt in detail in Lesson Board Committees.

DISCLOSURE AND TRANSPARENCY

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) referred to in clause (c) section 134(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

Provision to section 178(4) states that the board’s Report shall disclose the policy according to which The Nomination and Remuneration Committee 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

As per section 149(10) an independent director shall be eligible to reappointment on passing of a special resolution and disclosure of such appointment in the board's report. [Subject to the provision of 152]

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

Proviso to section 177(10) prescribes that the disclosure in board's report includes the detail of establishment of vigil mechanism under section 177(9).

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 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. 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.

Rule 5(2) of Companies (Appointment and Remuneration) Rules, 2014 made under Chapter IV provides the following disclosure on particulars of employees:-

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.

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

- (i) designation of the employee;
- (ii) remuneration received;
- (iii) nature of employment, whether contractual or otherwise;
- (iv) qualifications and experience of the employee;
- (v) date of commencement of employment;
- (vi) the age of such employee;
- (vii) the last employment held by such employee before joining the company;
- (viii) the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of sub-rule (2) above; and
- (ix) whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager:

Proviso (i) says that the particulars of employees posted and working in a country outside India, not being directors or their relatives, drawing more than sixty lakh rupees per financial year or five lakh rupees per month,

as the case may be, as may be decided by the Board, shall not be circulated to the members in the Board's report, but such particulars shall be filed with the Registrar of Companies while filing the financial statement and Board Reports:

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

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

D. Companies (Corporate Social Responsibility) Rules, 2014

Rule 8 of 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.

3. IN TERMS OF LISTING AGREEMENT

Clause 19

A company is required:

- to give prior intimation to the Stock Exchange about the Board Meeting at which proposal for Buyback of Securities, declaration/recommendation of Dividend or Rights or issue of convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of dividend is due to be considered at least 2 working days in advance;
- to give notice simultaneously to the Stock Exchanges in case the proposal for declaration of bonus is communicated to the Board of Directors of the company as part of the agenda papers.

Clause 20

The company will, immediately on the date of the meeting of its Board of Directors held to consider or decide the same, intimate to the Stock Exchange within 15 minutes of the closure of the Board Meetings by phone/fax/e-mail.

- all dividends and/or cash bonuses recommended or declared or the decision to pass any dividend or interest payment;
- the total turnover, gross profit/loss, provision for depreciation, tax provisions and net profits for the year (with comparison with the previous year) and the amounts appropriated from reserves, capital profits, accumulated profits of past years or other special source to provide wholly or partly for the dividend, even if this calls for qualification that such information is provisional or subject to audit.
- the decision on Buyback of Securities.

Clause 22

The Company will, immediately on the date of the meeting of its Board of Directors held to consider or decide

the same, intimate to the Stock Exchange within 15 minutes of the closure of the Board Meetings by Letter/ fax:

- short particulars of any increase of capital whether by issue of bonus shares through capitalization, or by way of right shares to be offered to the shareholders or debenture holders, or in any other way;
- short particulars of the 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;
- short particulars of any other alterations of capital, including calls;
- any other information necessary to enable the holders of the listed securities of the Company to appraise its position and to avoid the establishment of a false market in such listed securities.

Clause 29

The Company will promptly notify the Stock Exchange of any proposed change in the general character or nature of its business.

Clause 30

The Company will promptly notify the Stock Exchange:

- (a) of any change in the Company's directorate by death, resignation, removal or otherwise;
- (b) of any change of Managing Director, Managing Agents or Secretaries and Treasurers;
- (c) of any change of Auditors appointed to audit the books and accounts of the Company.

Clause 31

The Company will forward to the Stock Exchange promptly and without application:

- six copies of the Statutory and Directors Annual Reports, Balance Sheets and Profit and Loss Accounts and of all periodical and special reports as soon as they are issued and one copy each to all the recognised stock exchanges in India;
- six copies of all notices, resolutions and circulars relating to new issue of capital prior to their despatch to the shareholders;
- three copies of all the notices, call letters or any other circulars including notices of meetings convened u/s 230 or section 232 read with section 230 of the Companies Act, 2013 together with Annexures thereto, at the same time as they are sent to the shareholders, debenture holders or creditors or any class of them or advertised in the Press.
- copy of the proceedings at all Annual and Extraordinary General Meetings of the Company;
- three copies of all notices, circulars, etc., issued or advertised in the press either by the company, or by any company which it proposes to absorb or with which the Company proposes to merge or amalgamate, or under orders of the court or any other statutory authority in connection with any merger, amalgamation, re-construction, reduction of capital, scheme or arrangement, including notices, circulars, etc. issued or advertised in the press in regard to meetings of shareholders or debenture holders or creditors or any class of them and copies of the proceedings at all such meetings.

Clause 32

The Company shall supply:

- (i) Soft copies of full annual reports containing its Balance Sheet, Profit & Loss account and Directors Report to all those shareholder(s) who have registered their email address (es) for the purpose;

- (ii) Hard copy of statement containing the salient features of all the documents, as prescribed in section 136 of the Companies Act, 2013 to those shareholder(s) who have not so registered;
- (iii) Hard copies of full annual reports to those shareholders, who request for the same.

The Company will also give a Cash Flow Statement along with Balance Sheet and Profit and Loss Account. The Cash Flow Statement will be prepared in accordance with the Accounting Standard on Cash Flow Statement (AS-3) issued by the Institute of Chartered Accountants of India, and the Cash Flow Statement shall be presented only under the Indirect Method as given in AS-3.

The company will mandatorily publish Consolidated Financial Statements in its Annual Report in addition to the individual financial statements. The company will have to get its Consolidated Financial Statements audited by the statutory auditors of the company and file the same with the Stock Exchange. Companies shall be required to make disclosures in compliance with the Accounting Standard or "Related Party Disclosures" in the Annual Report.

Clause 35

The company will file the **Shareholding Pattern** including of promoters group with the exchange, separately for each class of equity shares/security in the specified formats, in compliance with the following timelines:-

- (a) One day prior to listing of its securities on the stock exchanges.
- (b) On a quarterly basis, within 21 days from the end of each quarter.
- (c) Within 10 days of any capital restructuring of the company resulting in a change exceeding + -2% of the total paid-up share capital.

Clause 35A

The company will submit to the stock exchange, within 48 hours of conclusion of its General Meeting, details regarding the voting results in the prescribed format.

Clause 35B

- (i) The issuer (company) shall provide e-voting facility to its shareholders, in respect of all shareholders' resolutions, to be passed at General Meetings or through postal ballot. Such e-voting facility shall be kept open for such period specified under the Companies (Management and Administration) Rules, 2014 for shareholders to send their assent or dissent.
- (ii) Issuer shall continue to enable those shareholders, who do not have access to e-voting facility, to send their assent or dissent in writing on a postal ballot as per the provisions of the Companies (Management and Administration) Rules, 2014 or amendments made thereto.
- (iii) Issuer shall utilize the service of any one of the agencies providing e-voting platform, which is in compliance with conditions specified by the Ministry of Corporate Affairs, Government of India, from time to time.
- (iv) Issuer shall mention the Internet link of such e-voting platform in the notice to their shareholders.

Clause 36

The Company will keep the Exchange informed of events such as strikes, lock-outs, closure on account of power cuts, etc. and all events which will have a bearing on the performance / operations of the company as well as price sensitive information both at the time of occurrence of the event and subsequently after the cessation of the event in order to enable the shareholders and the public to appraise the position of the company and to avoid the establishment of a false market in its securities.

Clause 41

The company has an option either to submit audited or unaudited quarterly and year to date financial results to

the stock exchange within forty-five days of end of each quarter (other than the last quarter). If the company decided to submit the unaudited quarterly results then it shall be subjected to limited review by the statutory auditors of the company (or in case of public sector undertakings, by any practicing Chartered Accountant) and such limited reviewed results (financial results accompanied by the limited review report) shall be submitted to the exchange within forty-five days from the end of the quarter.

In respect of the last quarter, the company shall submit audited financial results for the entire financial year within sixty days of the end of the financial year.

The quarterly financial results shall be approved by the Board of Directors of the company or by a committee thereof, other than the audit committee. The committee shall consist of not less than one third of the directors and shall include the managing director and at least one independent director. When the financial results are approved by the Committee, they shall be placed before the Board at its next meeting

The financial results shall be submitted to the stock exchange within fifteen minutes of conclusion of the meeting of the Board or Committee in which results were approved, through such mode as may be specified by the stock exchange.

The financial results submitted to the stock exchange shall be signed by the Chairman or Managing Director, or a Whole Time Director. In the absence of all of them, it shall be signed by any other director of the company who is duly authorized by the Board to sign the financial results.

The company shall give prior intimation of the date and purpose of meetings of the Board or Committee in which the financial results will be considered at least seven clear calendar days prior to the meeting (excluding the date of the intimation and date of the meeting) to the stock exchange.

The company shall also simultaneously issue a public notice in at least in one English daily newspaper circulating in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the company is situated.

The company shall, within 48 hours of conclusion of the Board or Committee meeting at which the financial results were approved, publish a copy of the financial results which were submitted to the stock exchange in at least in one English daily newspaper circulating in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the company is situated.

'quarter' means the period of three months commencing on the first day of April, July, October or January of a financial year.

Clause 49

SEBI requires the Listed companies to include a separate report on Corporate Governance in their Annual Report by including Clause 49 in the Listing Agreement (**Text of Clause 49 is placed as Annexure**). The disclosures about Corporate Governance to be made in the Annual Report are as under:

- (1) Disclosures on mandatory requirements
- (2) Disclosure on non-mandatory requirements

Disclosures on mandatory requirements

Clause 49 (I) (C) of the Listing agreement provides for the Disclosure and Transparency

1. The company should ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the company.
 - (a) Information should be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.

- (b) Channels for disseminating information should provide for equal, timely and cost efficient access to relevant information by users.
- (c) The company should maintain minutes of the meeting explicitly recording dissenting opinions, if any.
- (d) The company should implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and should also ensure that the annual audit is conducted by an independent, competent and qualified auditor.

A. Related Party Transactions

1. Details of all material transactions with related parties shall be disclosed quarterly along with the compliance report on corporate governance.
2. The company shall disclose the policy on dealing with Related Party Transactions on its website and also in the Annual Report.

B. 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 in the Corporate Governance Report.

C. Remuneration of Directors

1. All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company 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 company shall publish its criteria of making payments to non-executive directors in its annual report. Alternatively, this may be put up on the company's website and reference drawn thereto in the annual report.
4. The company shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report.
5. Non-executive directors shall be required to disclose their shareholding (both own or held by / for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment. These details should be disclosed in the notice to the general meeting called for appointment of such director.

D. Management

1. As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis

should include discussion on the following matters within the limits set by the company's competitive position:

- (a) Industry structure and developments.
 - (b) Opportunities and Threats.
 - (c) Segment-wise or product-wise performance.
 - (d) Outlook
 - (e) Risks and concerns.
 - (f) Internal control systems and their adequacy.
 - (g) Discussion on financial performance with respect to operational performance.
 - (h) Material developments in Human Resources / Industrial Relations front, including number of people employed.
2. 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 at large (for 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 the Board of Directors). This would also include all members of management one level below the executive directors including all functional heads.

3. The Code of Conduct for the Board of Directors and the senior management shall be disclosed on the website of the company.

E. Shareholders

1. 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 in Clause 49 (IV) (E) (v) above
2. Disclosure of relationships between directors inter-se shall be made in the Annual Report, notice of appointment of a director, prospectus and letter of offer for issuances and any related filings made to the stock exchanges where the company is listed.
3. Quarterly results and presentations made by the company to analysts shall be put on company's web-site, or shall 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.
4. 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.

5. To expedite the process of share transfers, the Board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

F. Disclosure of resignation of directors

1. The company shall disclose the letter of resignation along with the detailed reasons of resignation provided by the director of the company on its website not later than one working day from the date of receipt of the letter of resignation.
2. The company shall also forward a copy of the letter of resignation along with the detailed reasons of resignation to the stock exchanges not later than one working day from the date of receipt of resignation for dissemination through its website.

G. Disclosure of formal letter of appointment

1. The letter of appointment of the independent director along with the detailed profile shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.

H. Disclosures in Annual report

1. The details of training imparted to Independent Directors shall be disclosed in the Annual Report.
2. The details of establishment of vigil mechanism shall be disclosed by the company on its website and in the Board's report.
3. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.

I. Proceeds from public issues, rights issue, preferential issues, etc.

When money is raised through an issue (public issues, rights issues, preferential issues etc.), the company shall disclose the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results to the Audit Committee. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and place it before the audit committee. Such disclosure shall be made only till such time that the full money raised through the issue has been fully spent. This statement shall be certified by the statutory auditors of the company. Furthermore, where the company has appointed a monitoring agency to monitor the utilisation of proceeds of a public or rights issue, it shall place before the Audit Committee the monitoring report of such agency, upon receipt, without any delay. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

As per Clause 54 of the listing agreement the company shall maintain a functional website containing basic information about the company e.g. details of its business, financial information, shareholding pattern, compliance with corporate governance, contact information of the designated officials of the company who are responsible for assisting and handling investor grievances, details of agreements entered into with the media companies and/or their associates, etc. The company also ensures that the contents of the said website are updated at any given point of time.

Report on Corporate Governance

Clause 49(X) of the Listing agreement provides that there shall be a separate section on Corporate Governance in the Annual Reports of Company, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirement of this clause with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted.

The companies shall submit a quarterly compliance report in prescribed format to the stock exchanges within 15

days from the close of quarter. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company.

Disclosures on non-mandatory requirements

These requirements may be implemented at the discretion of the company. However, the disclosures of the compliance with mandatory requirements and adoption (and compliance)/non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report.

1. **The Board** - A non-executive Chairman may be entitled to maintain a Chairman's office at the company's expense and also allowed reimbursement of expenses incurred in performance of his duties.
2. **Shareholder Rights**- A half-yearly declaration of financial performance including summary of the significant events in last six-months, may be sent to each household of shareholders.
3. **Audit qualifications**-Company may move towards a regime of unqualified financial statements.
4. **Separate posts of Chairman and CEO** -The Company may appoint separate persons to the post of Chairman and Managing Director/CEO.
5. **Reporting of Internal Auditor**-The Internal auditor may report directly to the Audit Committee.

Clause 52

Corporate Filing and Dissemination System (CFDS), viz., www.corpfiling.co.in to file on the CDFS, such information, statements and reports as may be specified by the Participating Stock Exchanges in this regard within the time limit specified in the respective clause of the listing agreement.

Clause 55

Securities Exchange Board of India (SEBI) *vide* circular CIR/CFD/DIL/8/2012 dated August 13, 2012 inserted a new Clause 55 in the listing agreement by **mandating inclusion of Business Responsibility (BR) Reports as part of the Annual Reports for listed entities**. As per the circular the requirement to include BR Reports as part of the Annual Reports shall be mandatory for top 100 listed entities based on market capitalisation at BSE and NSE as on March 31, 2012. Other listed entities may voluntarily disclose BR Reports as part of their Annual Reports.

The Clause 55 prescribed that listed entities shall submit, as part of their Annual Reports, Business Responsibility Reports, describing the initiatives taken by them from an environmental, social and governance perspective, in the prescribed format.

4. DISCLOSURES IN TERMS OF SEBI REGULATIONS

Some of the other important disclosures envisaged are under the SEBI Guidelines are in terms of:

A. Securities and Exchange Board of India (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. Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

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

Disclosure of acquisition and disposal (Regulation 29)

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

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

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

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

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

Continual disclosures (Regulation 30)

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

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

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

(b) the target company at its registered office.

Disclosure of encumbered shares (Regulation 31)

1. The promoter of every target company shall disclose details of shares in such target company encumbered by him or by persons acting in concert with him in the prescribed format.
2. The promoter of every target company shall disclose details of any invocation of such encumbrance or release of such encumbrance of shares in prescribed format.
3. The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within seven working days from the creation or invocation or release of encumbrance, as the case may be to,—
 - (a) every stock exchange where the shares of the target company are listed; and
 - (b) the target company at its registered office.

C. Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992

Disclosure of interest or holding by directors and officers and substantial shareholders in listed companies - Initial Disclosure. (Regulation 13)

- (1) Any person who holds more than 5% shares or voting rights in any listed company shall disclose to the company in the prescribed form, the number of shares or voting rights held by such person, on becoming such holder, within 2 (two) working days of:—
 - (a) the receipt of intimation of allotment of shares; or
 - (b) the acquisition of shares or voting rights, as the case may be.
- (2) Any person who is a director or officer of a listed company shall disclose to the company in the prescribed form, the number of shares or voting rights held and positions taken in derivatives by such person and his dependents, within 2 working days of becoming a director or officer of the company.

Continual disclosure

Any person who holds more than 5% shares for voting rights in any listed company shall disclose to the company in the prescribed form the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below 5%, if there has been change in such holdings from the last disclosure made and such change exceeds 2% of total shareholding or voting rights in the company.

Any person who is a director or officer of a listed company, shall disclose to the company and the stock exchange where the securities of the company are listed, in the prescribed form, the total number of shares or voting rights held and change in shareholding or voting rights, if there has been a change in such holdings of such person and his dependents from the last disclosure made and the change exceeds Rs. 5 lakh in value or 25,000 shares or 1% of total shareholding or voting rights, whichever is lower.

These disclosures shall be made within 2 working days of:

- (a) the receipts of intimation of allotment of shares, or
- (b) the acquisition or sale of shares or voting rights, as the case may be.

Disclosure by company to stock exchanges

Every listed company shall disclose to all stock exchanges on which the company is listed, the information received under these regulation, within 2 working days of receipt.

Code of internal procedures and conduct for listed companies and other entities (Regulation 12)

All listed companies and organisations associated with securities markets including:

- the intermediaries as mentioned in Section 12 of the SEBI Act, asset management company and trustees of mutual funds;
- the self-regulatory organisations recognised or authorised by the Board;
- the recognised stock exchanges and clearing house or corporations;
- the public financial institutions as defined in Section 2 (72) of the Companies Act, 2013; and
- the professional firms such as auditors, accountancy firms, law firms, analysts, consultants, etc., assisting or advising listed companies,

shall frame a code of internal procedures and conduct as near thereto the Model Code specified under these regulations without diluting it in any manner and ensure compliance of the same.

The aforesaid entities shall abide by the code of Corporate Disclosure Practices as specified under these regulations and are required to adopt appropriate mechanisms and procedures to enforce the codes specified.

CONCLUSION

The coverage in this study lesson is restricted only to the provisions of the Companies Act, 2013, Listing Agreement and SEBI Regulations. However, corporate governance concept is covered under a wide array of legislations. Businesses drive the economy and derive its sustenance from the economy. The legislations pertaining to labour laws such as Payment of wages Act, Payment of Bonus Act, Industrial Disputes Act, Workmen Compensation Act etc protects employees who are one of the main stakeholders. Environmental laws help and goad the corporates to act in a sustainable manner. Competition laws, consumer protection laws help companies adopt the best market practices.

ANNEXURE

Revised Clause 49 of the Listing Agreement

I. The company agrees to comply with the provisions of Clause 49 which shall be implemented in a manner so as to achieve the objectives of the principles as mentioned below. In case of any ambiguity, the said provisions shall be interpreted and applied in alignment with the principles.

A. *The Rights of Shareholders*

1. The company should seek to protect and facilitate the exercise of shareholders' rights.
 - (a) Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes.
 - (b) Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings.
 - (c) Shareholders should be informed of the rules, including voting procedures that govern general shareholder meetings.
 - (d) Shareholders should have the opportunity to ask questions to the board, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.
 - (e) Effective shareholder participation in key Corporate Governance decisions, such as the nomination and election of board members, should be facilitated.
 - (f) The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.
 - (g) The Company should have an adequate mechanism to address the grievances of the shareholders.
 - (h) 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.

2. The company should provide adequate and timely information to shareholders.
 - (a) 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 discussed at the meeting.
 - (b) Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.
 - (c) All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase.
3. The company should ensure equitable treatment of all shareholders, including minority and foreign shareholders.
 - (a) All shareholders of the same series of a class should be treated equally.
 - (b) Effective shareholder participation in key Corporate Governance decisions, such as the nomination and election of board members, should be facilitated.
 - (c) Exercise of voting rights by foreign shareholders should be facilitated.
 - (d) The company should devise a framework to avoid Insider trading and abusive self-dealing.
 - (e) Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders.
 - (f) Company procedures should not make it unduly difficult or expensive to cast votes.

B. Role of stakeholders in Corporate Governance

1. The company should recognise the rights of stakeholders and encourage co-operation between company and the stakeholders.
 - (a) The rights of stakeholders that are established by law or through mutual agreements are to be respected.
 - (b) Stakeholders should have the opportunity to obtain effective redress for violation of their rights.
 - (c) Company should encourage mechanisms for employee participation.
 - (d) 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.
 - (e) The company 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.

C. Disclosure and transparency

1. The company should ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the company.
 - (a) Information should be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.
 - (b) Channels for disseminating information should provide for equal, timely and cost efficient access to relevant information by users.
 - (c) The company should maintain minutes of the meeting explicitly recording dissenting opinions, if any.
 - (d) The company should implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and should also ensure that the annual audit is conducted by an independent, competent and qualified auditor.

D. Responsibilities of the Board

1. Disclosure of Information

- (a) 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 company.
- (b) The Board and top management should 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 for good decision-making.

2. Key functions of the Board

The board should fulfill certain key functions, including:

- (a) 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.
- (b) Monitoring the effectiveness of the company's governance practices and making changes as needed.
- (c) Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
- (d) Aligning key executive and board remuneration with the longer term interests of the company and its shareholders.
- (e) Ensuring a transparent board nomination process with the diversity of thought, experience, knowledge, perspective and gender in the Board.
- (f) Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
- (g) Ensuring the integrity of the company'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.
- (h) Overseeing the process of disclosure and communications.
- (i) Monitoring and reviewing Board Evaluation framework.

Other responsibilities

- (a) The Board should provide the strategic guidance to the company, ensure effective monitoring of the management and should be accountable to the company and the shareholders.
- (b) The Board should set a corporate culture and the values by which executives throughout a group will behave.
- (c) Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.
- (d) The Board should encourage continuing directors training to ensure that the Board members are kept up to date.
- (e) Where Board decisions may affect different shareholder groups differently, the Board should treat all shareholders fairly.
- (f) The Board should apply high ethical standards. It should take into account the interests of stakeholders.

- (g) The Board should be able to exercise objective independent judgement on corporate affairs.
- (h) Boards should consider assigning a sufficient number of non-executive Board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest.
- (i) The Board should 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 company to excessive risk.
- (j) The Board should 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 company's focus.
- (k) When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.
- (l) Board members should be able to commit themselves effectively to their responsibilities.
- (m) In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.
- (n) The Board and senior management should facilitate the Independent Directors to perform their role effectively as a Board member and also a member of a committee.

II. Board of Directors

A. Composition of Board

1. 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.
2. Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise independent directors and in case the company 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 Chairman is a promoter of the company 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."

B. Independent Directors

1. For the purpose of the clause A, the expression 'independent director' shall mean a non-executive director, other than a nominee director of the company:
 - (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) apart from receiving director's remuneration, 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;
- (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;
 - (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 non-profit 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;
 - (v) is a material supplier, service provider or customer or a lessor or lessee of the company;
 - (vi) who is not less than 21 years of age.

Explanation

For the purposes of the sub-clause (1):

- (i) "Associate" shall mean a company which is an "associate" as defined in Accounting Standard (AS) 23, "Accounting for Investments in Associates in Consolidated Financial Statements", issued by the Institute of Chartered Accountants of India.
- (ii) "Key Managerial Personnel" shall mean "Key Managerial Personnel" as defined in section 2(51) of the Companies Act, 2013.
- (iii) "Relative" shall mean "relative" as defined in section 2(77) of the Companies Act, 2013 and rules prescribed there under.

2. Limit on number of directorships

- (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.

3. Maximum tenure of Independent Directors

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.

4. 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 and the Stock Exchanges not later than one working day from the date of such appointment.

5. Performance evaluation of Independent Directors

- (a) The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors.
- (b) The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report.
- (c) The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated).
- (d) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

6. 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.

7. Training of Independent Directors

- (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.
- (c) Non-executive Directors' compensation and disclosures

All fees / compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in general meeting. The shareholders' resolution shall specify the limits for the maximum number of stock options that can be granted to non-executive directors, in any financial year and in aggregate.

Provided that the requirement of obtaining prior approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 2013 for payment of sitting fees without approval of the Central Government.

Provided further that independent directors shall not be entitled to any stock option.

D. Other provisions as to Board and Committees

1. The Board shall meet at least four times a year, with a maximum time gap of one hundred and twenty days between any two meetings. The minimum information to be made available to the Board is given in Annexure - X to the Listing Agreement.

2. 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, every director shall inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

Explanation:

(i) 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.

(ii) For the purpose of reckoning the limit under this sub-clause, Chairmanship / membership of the Audit Committee and the Stakeholders' Relationship Committee alone shall be considered.

3. The Board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.

4. An independent director who resigns or is removed from the Board of the Company 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.

5. Provided that 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.

6. The Board of the company shall satisfy itself that plans are in place for orderly succession for to the Board and to senior management.

E. Code of Conduct

1. 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.

2. 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 the CEO.

3. The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013.

4. 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 with respect of the provisions contained in the Listing Agreement.

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 executive directors, including all functional heads.

F. Whistle Blower Policy

1. The company shall establish a vigil mechanism for directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy.
2. 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 Chairman of the Audit Committee in exceptional cases.
3. The details of establishment of such mechanism shall be disclosed by the company on its website and in the Board’s report.

III. Audit Committee

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. 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 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.

Explanation (i): The term “related party transactions” shall have the same meaning as provided in Clause 49(VII) of the Listing Agreement.

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.

IV. Nomination and Remuneration Committee

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.

V. Subsidiary Companies

A. At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of a material non-listed Indian subsidiary company.

B. The Audit Committee of the listed holding company shall also review the financial statements, in particular, the investments made by the unlisted subsidiary company.

C. The minutes of the Board meetings of the unlisted subsidiary company shall be placed at the Board meeting of the listed holding company. The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.

D. The company shall formulate a policy for determining 'material' subsidiaries and such policy shall be disclosed to Stock Exchanges and in the Annual Report.

E. For the purpose of this clause, a subsidiary shall be considered as material if the investment of the company in the subsidiary exceeds twenty per cent of its consolidated net worth as per the audited balance sheet of the previous financial year or if the subsidiary has generated twenty per cent of the consolidated income of the company during the previous financial year.

F. No company shall dispose of shares in its material subsidiary which would reduce its shareholding (either on its own or together with other subsidiaries) to less than 50% or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting.

G. Selling, disposing and leasing of assets amounting to more than twenty percent of the assets of the material subsidiary shall require prior approval of shareholders by way of special resolution

Explanation (i): The term "material non-listed Indian subsidiary" shall mean an unlisted subsidiary, incorporated in India, whose income or net worth (i.e. paid up capital and free reserves) exceeds 20% of the consolidated income or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

Explanation (ii): The term "significant transaction or arrangement" shall mean any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the material unlisted subsidiary for the immediately preceding accounting year.

Explanation (iii): Where a listed holding company has a listed subsidiary which is itself a holding company, the above provisions shall apply to the listed subsidiary insofar as its subsidiaries are concerned.

VI. Risk Management

A. The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures.

B. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.

C. The company shall also 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.

VII. Related Party Transactions

A. A related party transaction is a transfer of resources, services or obligations between a company and a related party, regardless of whether a price is charged.

B. A 'related party' is a person or entity that is related to the company. Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions and includes the following:

1. A person or a close member of that person's family is related to a company if that person:
 - (a) is a related party under Section 2(76) of the Companies Act, 2013; or
 - (b) has control or joint control or significant influence over the company; or
 - (c) is a key management personnel of the company or of a parent of the company; or
2. An entity is related to a company if any of the following conditions applies:
 - (a) The entity is a related party under Section 2(76) of the Companies Act, 2013; or
 - (b) The entity and the company are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others); or
 - (c) 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); or
 - (d) Both entities are joint ventures of the same third party; or
 - (e) One entity is a joint venture of a third entity and the other entity is an associate of the third entity; or
 - (f) The entity is a post-employment benefit plan for the benefit of employees of either the company or an entity related to the company. If the company is itself such a plan, the sponsoring employers are also related to the company; or
 - (g) The entity is controlled or jointly controlled by a person identified in (1).
 - (h) A person identified in (1)(b) has significant influence over the entity (or of a parent of the entity); or

Explanation: For the purpose of Clause 49(V) and Clause VII (B), the term "control" shall have the same meaning as defined in SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

C. The company shall formulate a policy on materiality of related party transactions and also on dealing with Related Party Transactions. Provided that a transaction with a related party shall be considered material if the transaction / transactions to be entered into individually or taken together with previous transactions during a financial year, exceeds five percent of the annual turnover or twenty percent of the net worth of the company as per the last audited financial statements of the company, whichever is higher.

D. All Related Party Transactions shall require prior approval of the Audit Committee.

E. All material Related Party Transactions shall require approval of the shareholders through special resolution and the related parties shall abstain from voting on such resolutions.

VIII. Disclosures

A. Related Party Transactions

1. Details of all material transactions with related parties shall be disclosed quarterly along with the compliance report on corporate governance.
2. The company shall disclose the policy on dealing with Related Party Transactions on its website and also in the Annual Report.

B. 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 in the Corporate Governance Report.

C. Remuneration of Directors

1. All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company 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 company shall publish its criteria of making payments to non-executive directors in its annual report. Alternatively, this may be put up on the company's website and reference drawn thereto in the annual report.
4. The company shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report.
5. Non-executive directors shall be required to disclose their shareholding (both own or held by / for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment. These details should be disclosed in the notice to the general meeting called for appointment of such director.

D. Management

1. As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company's competitive position:
 - (a) Industry structure and developments.
 - (b) Opportunities and Threats.
 - (c) Segment-wise or product-wise performance.
 - (d) Outlook
 - (e) Risks and concerns.
 - (f) Internal control systems and their adequacy.
 - (g) Discussion on financial performance with respect to operational performance.
 - (h) Material developments in Human Resources / Industrial Relations front, including number of people employed.
2. 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 at large (for 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 the Board of Directors). This would also include all members of management one level below the executive directors including all functional heads.

3. The Code of Conduct for the Board of Directors and the senior management shall be disclosed on the website of the company.

E. Shareholders

1. 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 in Clause 49 (IV) (E) (v) above
2. Disclosure of relationships between directors inter-se shall be made in the Annual Report, notice of appointment of a director, prospectus and letter of offer for issuances and any related filings made to the stock exchanges where the company is listed.
3. Quarterly results and presentations made by the company to analysts shall be put on company's website, or shall 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.
4. 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.
5. To expedite the process of share transfers, the Board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

F. Disclosure of resignation of directors

1. The company shall disclose the letter of resignation along with the detailed reasons of resignation provided by the director of the company on its website not later than one working day from the date of receipt of the letter of resignation.
2. The company shall also forward a copy of the letter of resignation along with the detailed reasons of resignation to the stock exchanges not later than one working day from the date of receipt of resignation for dissemination through its website.

G. Disclosure of formal letter of appointment

The letter of appointment of the independent director along with the detailed profile shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.

H. Disclosures in Annual report

1. The details of training imparted to Independent Directors shall be disclosed in the Annual Report.

2. The details of establishment of vigil mechanism shall be disclosed by the company on its website and in the Board's report.
3. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.

I. Proceeds from public issues, rights issue, preferential issues, etc.

When money is raised through an issue (public issues, rights issues, preferential issues etc.), the company shall disclose the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results to the Audit Committee. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and place it before the audit committee. Such disclosure shall be made only till such time that the full money raised through the issue has been fully spent. This statement shall be certified by the statutory auditors of the company. Furthermore, where the company has appointed a monitoring agency to monitor the utilisation of proceeds of a public or rights issue, it shall place before the Audit Committee the monitoring report of such agency, upon receipt, without any delay. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

IX. CEO/CFO certification

The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function 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. . 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.

X. Report on Corporate Governance

A. There shall be a separate section on Corporate Governance in the Annual Reports of company, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirement of this clause with reasons thereof and the extent to which the non-mandatory requirements have been adopted should

be specifically highlighted. The suggested list of items to be included in this report is given in Annexure - XII to the Listing Agreement and list of non-mandatory requirements is given in Annexure - XIII to the Listing Agreement.

B. The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format given in Annexure - XI to the Listing Agreement. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company.

XI. Compliance

A. The company shall obtain a certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.

B. The non-mandatory requirements given in Annexure - XIII to the Listing Agreement may be implemented as per the discretion of the company. However, the disclosures of the compliance with mandatory requirements and adoption (and compliance) / non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report.

Annexure - X to the Listing Agreement

Information to be placed before Board of Directors

1. Annual operating plans and budgets and any updates.
2. Capital budgets and any updates.
3. Quarterly results for the company and its operating divisions or business segments.
4. Minutes of meetings of audit committee and other committees of the board.
5. The information on recruitment and remuneration of senior officers just below the board level, including appointment or removal of Chief Financial Officer and the Company Secretary.
6. Show cause, demand, prosecution notices and penalty notices which are materially important.
7. Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.
8. Any material default in financial obligations to and by the company, or substantial nonpayment for goods sold by the company.
9. Any issue, which involves possible public or product liability claims of substantial nature, including any judgement or order which, may have passed strictures on the conduct of the company or taken an adverse view regarding another enterprise that can have negative implications on the company.
10. Details of any joint venture or collaboration agreement.
11. Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.
12. Significant labour problems and their proposed solutions. Any significant development in Human Resources/ Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc.
13. Sale of material nature, of investments, subsidiaries, assets, which is not in normal course of business.
14. Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.
15. Non-compliance of any regulatory, statutory or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.

Annexure - XI to the Listing Agreement

Format of Quarterly Compliance Report on Corporate Governance

Name of the Company:

Quarter ending on: Particulars	Clause of Listing agreement	Compliance Status Yes/No	Remarks
II. Board of Directors		49 (II)	
(A) Composition of Board		49 (IIA)	
(B) Independent Directors		49 (IIB)	
(C) Non-executive Directors' compensation & disclosures		49 (IIC)	
(D) Other provisions as to Board and Committees		49 (IID)	
(E) Code of Conduct		49 (IIE)	
(F) Whistle Blower Policy		49 (IIF)	
III. Audit Committee		49 (III)	
(A) Qualified & Independent Audit Committee		49 (IIIA)	
(B) Meeting of Audit Committee		49 (IIIB)	
(C) Powers of Audit Committee		49 (IIIC)	
(D) Role of Audit Committee		49 (IIID)	
(E) Review of Information by Audit Committee		49 (IIIE)	
IV. Nomination and Remuneration Committee		49 (IV)	
V. Subsidiary Companies		49 (V)	
VI. Risk Management		49 (VI)	
VII. Related Party Transactions		49 (VII)	
VIII. Disclosures		49 (VIII)	
(A) Related party transactions		49 (VIII A)	
(B) Disclosure of Accounting Treatment		49 (VIII B)	
(C) Remuneration of Directors		49 (VIII C)	
(D) Management		49 (VIII D)	
(E) Shareholders		49 (VIII E)	
(F) Disclosure of resignation of directors		49 (VIII F)	
(G) Disclosure of formal letter of appointment		49 (VIII G)	
(H) Disclosures in the Annual report		49 (VIII H)	
(I) Proceeds from public issues, rights		49 (VIII I)	

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, 1992
 - Listing Agreement

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 agreement
 - (c) Shareholders rights
3. What is the provision for Board composition in the listing agreement?
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 well divided four segments.

The first segment of 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; Lead Independent Director; The second segment of the study focuses on Board processes & Board Charter etc.

The third segment of the study enables the students to understand the concept of Board responsibility, Leadership Development, Relationship between Directors and Executive, The Key difference between Directors and Managers, Barriers to Visionary Leadership etc.

The fourth and 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 leadership culture is one where everyone thinks like an owner, a CEO or a managing director. It’s one where everyone is entrepreneurial and proactive.”

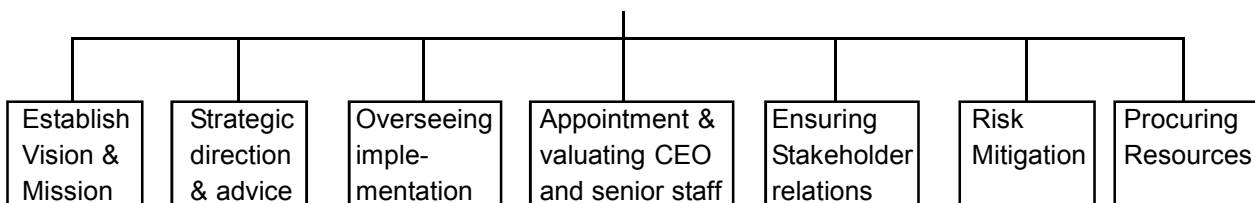
– Robin S. Sharma

INTRODUCTION

<p>The contribution of directors on the Board of companies is critical for ensuring appropriate directions with regard to leadership, vision, strategy, policies, monitoring, supervision, 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.</p>	<p>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 board of directors is that of trust as the board is entrusted with the responsibility to act in the best interests of the company within a framework of prudent and effective controls 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 board of directors is that of trust as the board is entrusted with the responsibility to act in the best interests of the company.</p> <p>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.</p> <p>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 cornerstone in evolving sound, efficient, vibrant and dynamic corporate sector for attaining of high standards in integrity, transparency, code of conduct, accountability as well as the social responsibility.</p>
---	--

SEGMENT I - ROLE OF DIRECTORS

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. Organization's activities should be consistent with its stated purpose. The Board ensures that the organization effectively and efficiently work towards achieving its mission and be 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 organizations mission at all times.

Strategic Direction and advice: Board is to review and approve management's strategy, plans and decisions, financial objectives, extra-ordinary 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, however, 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 and other senior management officers 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 is responsible for

- Hiring the senior staff person;
- Giving direction to the senior staff person, and;
- Evaluating the senior staff person.

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 organizations purpose, goals and objectives, programs 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 organisation from reaching its goals. The whole 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 organisation and to make sure plans are in place that will minimise the impact of events or changes that will have a negative effect. Each company will face a different risk profile. 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, business relationship are the key resources that are essential to an organization's success. Boards play an important role in helping the organization 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 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 (Aufsichtsrat) 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?

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

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

GOVERNANCE FUNCTIONARIES

1. Executive Director

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

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

Executive directors are usually 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 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 director.

3. Shadow Director

Shadow Director is a person who is not formally appointed as a director, but in accordance with whose directions or instructions the directors of a company are accustomed to act. 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.

Clause 49(II) (A) of the Listing Agreement also requires that at least one woman director shall be appointed on the board of all listed companies.

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, 1973 Lord Watkinson was appointed by Confederation of British Industries to recommend on 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.

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 diverge 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", 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."

A. 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".

B. 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.

C. Companies Act, 2013 and various Rules made there under

Who is an Independent Director?

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;

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 hold two per cent. or more of the total voting power of the company; or
- (f) who possesses such other qualifications as may be prescribed.

Who shall appoint Independent Director?

Section 149(4) read with Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 provides for such class or classes of companies where the appointment of Independent director is mandatory. (Discussed in Lesson 4)

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 website of Ministry of Corporate Affairs or any other notified website. Company must exercise due diligence before selecting a person from the data bank referred to above, as an independent director.

This section further stipulates that the appointment of independent directors has to be approved by members in a General meeting and the explanatory statement annexed to the notice must indicate justification for such appointment.

Any person who desires to get his name included in the data bank of independent directors shall make an application to the agency in Form DIR-1 Application 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) contains a link to obtain the software required to view print the particulars free of charge.

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 loses his independent status while holding his office. In such a situation the director must approach the Board and communicate his status, in turn 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 are Code of Conduct for an Independent Director?

Eighth proviso to 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.

The code of conduct for independent directors regarding 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 its independence or may become not so independent due to friendship 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))

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 “upto five consecutive years” for an Independent Directors. 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 related 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 lay 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.

D. Clause 49 of the Listing Agreement***Meaning***

The expression 'independent director' shall mean a non-executive director, other than a nominee director of the company:

- (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) apart from receiving director's remuneration, 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;
- (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 non-profit 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;

(v) is a material supplier, service provider or customer or a lessor or lessee of the company;

(f) who is not less than 21 years of age.

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

(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 and the Stock Exchanges not later than one working day from the date of such appointment.

Performance evaluation of Independent Directors

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

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

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

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

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.

Training of Independent Directors

- (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.

Remuneration to Independent Directors

Clause 49 provides that all fees/ compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in general meeting. The shareholders' resolution shall specify the limits for the maximum number of stock options that can be granted to non-executive directors, in any financial year and in aggregate.

Provided that the requirement of obtaining prior approval of shareholders in general meeting shall not apply to payment of sitting fee to non-executive directors, if made within the limits prescribed under the Companies act, 2013 for the payment of sitting fees without approval of the Central government.

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.

While Clause 49 specifically provides that nominee directors appointed by an institution, which has invested in or lent to the company shall be deemed to be independent directors. Section 149(6) of the Companies Act, 2013 specifically excludes 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 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 upto 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.

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.

Clause 49 further provides that in case the Chairman of the board is a non –executive director, at least one-third of the Board should comprise independent directors and in case the company 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)

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

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.



The chairman may be a person outside the board?

– True or False

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:

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 corporates, business, economic and tax laws
- is an important member of the corporate management team and acts as conscience seeker 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 prescribed 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) lays 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 mix of inside and Independent Directors with a variety of experience and core competence. The potential competitive advantage of a Board structure constituted of executive directors and independent non-executive directors is in its combinations of – the depth of knowledge of the business of the executives and the breadth of experience of the non-executive/independent/outside 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

The Board Composition in the Indian context is governed by the Listing Agreement in case of listed companies. Clause 49 of the Listing Agreement 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 Chairman of the Board is a non-executive director, at least one-third of the Board should comprise independent directors and in case the company 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 Chairman is a promoter of the company 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.



What is the maximum number of companies in which a person can be a director?

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

134 PP-EGAS

- 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 will not accept gifts, services, benefits or hospitality that might influence, or appear to influence, the Directors' and Officers' conduct in representing the Company.
- Board Evaluation
- Directors liability insurance
- Director Induction
- Non-Executive Director Remuneration
- Director 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 obligation 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.

Agenda

The agenda should be made available to the Board along with supporting papers at least seven days before 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 independent directors to pre-emptly 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:

1. **Short.** Board papers associated with a particular agenda item should be set out as an executive summary with further detail provided in annexes.

2. **Timely.** Information should be distributed at least seven business days before the meeting.
3. **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:

- (a) An agenda, this should be on one page.
- (b) Minutes from last meeting along with action taken report.
- (c) Minutes of Committee Meetings.
- (d) 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

- The Act provides that the first Board meeting should be held within thirty days of the date of incorporation.
- 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.
- 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 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

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 record, the following namely :
- (a) name;
 - (b) the location from where he is participating;
 - (c) that he can completely and clearly see, hear and communicate with the other participants;
 - (d) that he has received the agenda and all the relevant material for the meeting; and
 - (e) that no one other than the concerned director is attending or having access to the proceedings of the meeting at the location mentioned in (b) above.
- (5) (a) After the roll call, the Chairperson or the Secretary shall inform the Board about the names of persons other than the directors who are present for the said meeting at the request or with the permission of the Chairman and confirm that the required quorum is complete.

Explanation: It is clarified that a director participating in a meeting through video conferencing or other audio visual means shall be counted for the purpose of quorum, unless he is to be excluded for any items of business under any provisions of the Act or the Rules.

- (b) The roll call shall also be made at the conclusion of the meeting and at the re-commencement of the meeting after every break to confirm the presence of a quorum throughout the meeting.
- (6) With respect to every meeting conducted through video conferencing or other audio visual means authorised under these rules, the scheduled venue of the meeting as set forth in the notice convening the meeting, 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 accounts; and
- (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 is in process to bring out the Secretarial Standards in line with Companies Act, 2013 and has already issued the exposure draft of Secretarial Standard related to Board and General Meeting.

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 concerned executive 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.

Minute book of General Meeting

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. This 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.

In general, remarks should not be attributed to individual directors.

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.



The minutes of the Board Meeting held on 28-11-2012 were not signed by the chairman of the meeting within 30 days. Consider the legal implications of this under Companies Act, 2013.

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.

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 independent non-executive Director or by 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, Clause 49 also mandates the separate meeting of independent directors for all the listed companies. The provisions given in the companies Act and that in the Clause 49 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.



Is conducting separate meetings a must for the companies under listing agreement clause 49?

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 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 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 biasness, partiality and favoritisms is eliminated with the concept of the board.

The purpose to have a board in the company is to have directors who are expected:

1. To contribute to the business of the company through their knowledge and skills.
2. To advise on such matters as need their attention and influence.
3. To critically analyze the performance and operations of the company.
4. To be able to act as a professional aide.
5. To be able to offer their professional expertise in the relevant field.
6. To establish sound business principles and ethics.
7. 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:

144 PP-EGAS

- 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.
- That company has policies for different class of stakeholders which are equally applicable. Such policies should be based on the principles of equity and justice.
- That 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 needed, 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.
- Follow board decorum and code for conduct of meetings.
- All relevant information is shared among themselves for a proper decision making.
- Enable to the board to take an 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 de-fines policy to include all possible pronouncements within a carefully crafted arrangement encompassing all board policies.

“It is the single, central repository of written board wisdom, rather than one of several board products. Replacing reams of previous board documents, these documents often number fewer than fifty pages—board members can actually master all of them, using them as working documents and making frequent amendments. Moreover, board policies are truly the board’s policies, having been generated from board deliberation, not parroted from management

recommendations. Explicit, comprehensive governing values of the organization enable new board members to find quickly what the board stands for. The chairperson and CEO have an unambiguous source for knowing board expectations of their roles”.

Policy Governance separates issues of organizational purpose (ENDS) from all other organizational issues (MEANS), placing primary importance on those Ends. Policy Governance boards demand accomplishment of purpose, and only limit the staff’s available means to those which do not violate the board’s pre-stated standards of prudence and ethics.

The board’s own Means are defined in accordance with the roles of the board, its members, the chair and other officers, and any committees the board may need to help it accomplish its job. This includes the necessity to “speak with one voice”. Dissent is expressed during the discussion preceding a vote. Once taken, the board’s decisions may subsequently be changed, but are never to be undermined. The board’s expectations for itself also set out self-imposed rules regarding the delegation of authority to the staff and the method by which board-stated criteria will be used for evaluation. Policy Governance boards delegate with care. There is no confusion about who is responsible to the board or for what board expectations they are responsible. Furthermore, boards that decide to utilize a CEO function are able to hold this one position exclusively accountable.

RELATIONSHIP BETWEEN DIRECTORS AND EXECUTIVE

Board and executive leadership need to work together based on mutual respect, trust and commitment. A board provides counsel to management and should not get involved in the day-to-day affairs of the organization. Clear expectations for the board and the director need to be established and maintained, because a board that is overly active in management can inhibit the organization’s effectiveness. The Executive Management can help the board govern more and manage less by adopting the following three methods:

- Use a **comprehensive strategic plan** that has been developed in conjunction with the board, and supplement it with regular progress reports. This will keep the board’s sights focused on the long term goals and mission of the organization. Regular reports will keep board members apprised of progress toward organizational goals, and provide part of the basis for evaluation of the executive management.
- Provide the board with **relevant materials before board meetings**, and explain why the materials are coming to the attention of the board. Let board members know how specific agenda items relate to the organization’s larger mission, and what kind of action or discussion is desired of the board on each item.
- **Facilitate board and board committee discussions** so that the board stays focused on the larger issues. Refer to set policies that define the limits of the board’s decision-making power, and strive to engage the board in a dialogue among themselves that leads to consensus-building.

THE KEY DIFFERENCE BETWEEN DIRECTORS AND MANAGERS

There are many fundamental differences between being a director and a manager. The differences are numerous, substantial and quite onerous. The table below gives a detailed breakdown of the major differences between directing and managing:

Basis	Directors	Managers
Leadership	It is the board of directors who must provide the intrinsic leadership and direction at the top of the organization.	It is the role of managers to carry through the strategy on behalf of the directors.
Decision Making	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.	Managers are concerned with Implementing the decisions and the policies made by the board.
Duties and responsibilities	Directors, not managers, have the ultimate responsibility for the longer-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 occasion, directors can be held responsible for acts of the company. Directors also owe certain duties to the stakeholders of the company.	Managers have far fewer legal responsibilities.
Relationship with shareholders	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 but also taking into account the best interests of the company (as a separate legal entity) and the other stakeholders.	Managers are usually appointed and dismissed by directors or management and do not have any legal requirement to be held to account.
Ethics and values	Directors have a key role in the determination of the value and ethical position of the company.	Managers must enact the ethos, taking their direction from the board.
Company Administration	Directors are responsible for the company's administration.	While the related duties associated with company administration can be delegated to managers, the ultimate responsibility for them resides with the directors.
Statutory Provisions on insolvency	If a company becomes insolvent, law imposes various duties and responsibilities on directors that may involve personal liability, criminal prosecution and disqualification.	These statutory provisions do not affect managers.
Statutory Provisions in general	There are many other statutory provisions that can create offences on strict liability under which Directors may face penalties if the company fails to comply. A very wide range of statutes impose duties on Directors which are numerous.	Generally managers are not responsible under the Statutory Provisions.
Disqualification	Directors can be disqualified as Directors under law.	The control over the employment of a Manager rests with the company.

(From website - Institute of Directors, UK)

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 venture is never granted. Boards need to acknowledge the tension point and discuss it with funders and other key supporters. Board leadership must strike a balance between taking chances and maintaining the traditional stewardship role.
- **Lack of Strategic Planning** - Strategic planning offers boards an opportunity to think about changes and trends that will have significant impact and develop strategies to respond to challenges. Some boards are not involved in strategic planning at all; others are involved in a superficial way. Therefore, the boards lose an important opportunity to hone/exercise visionary leadership skills.
- **Complexity** - Board members frequently lack a deep understanding of critical changes, trends and developments that challenge fundamental assumptions about how it defines its work and what success looks like. This lack of knowledge results in a lack of confidence on the part of the board to act decisively and authoritatively.
- **Micro Management** - It is necessary that the board focuses its attention on items of critical importance to the organization. If the board is tempted to micro manage or to meddle in lesser matters, an opportunity to provide visionary leadership is lost.
- **Clinging to Tradition** – Boards often resist change in order to preserve tradition. However, changing environment requires the Boards to be open to change. Maira and Scott - Morgan in “The Accelerating Organisation” point out that continuous shedding of operating rules is necessary because of changing environmental conditions. But shedding becomes more complicated in systems involving human beings, because their sense of self-worth is attached to many old rules. This human tendency to hold on to the known prevents boards from considering and pursuing new opportunities which conflict with the old rules.
- **Confused Roles** - Some boards assume that it is the job of the executive director to do the visionary thinking and that the board will sit and wait for direction and inspiration. This lack of clarity can result in boards that do not exercise visionary leadership because they do not think it is their job.
- **Past Habit** - Time was when clients, members and consumers would just walk in the door on their own. Viewing things in this way, boards did not consider market place 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 involves introducing 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 program 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 than that it 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 – Revised Clause 49 of Listing Agreement

- (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 encourage boards to pay greater attention to how they actually operate and in turn are very helpful in identifying ways to improve the board. As a result of such a process, suggestions and concerns about boardroom activities emerge more often and more constructively from board members.

Evaluations of group performance usually encourage a more thorough examination of an individual's and a group's responsibilities and roles. Board evaluations are no exception. By focusing on the board as a team and on its overall performance, communication and overall level of participation improved.

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—

- (1) Self-appraisal
- (2) 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

Revised Clause 49 of Listing Agreement provides 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 company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report.
- (c) The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated).
- (d) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

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 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 e.g.:

- 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:

1. How well prepared and informed are they for board meetings and is their meeting attendance satisfactory?
2. 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?
3. What has been the quality and value of their contributions at board meetings?
4. What has been their contribution to development of strategy and to risk management?
5. How successfully have they brought their knowledge and experience to bear in the consideration of strategy?
6. 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?

7. How effectively and proactively have they followed up their areas of concern?
8. How effective and successful are their relationships with fellow board members, the company secretary and senior management?
9. Does their performance and behavior engender mutual trust and respect within the board?
10. 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

- With the globalization and the blurring of the borders, the demands on the board has 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 – Audit Committee and Shareholders/Investors Grievance Committee.
- A key element in the corporate governance process of any organization is its audit committee. The battle for financial statement integrity and reliability depends on balancing the pressures of multiple stakeholders, including management, regulators, investors and the public interest.

- The Regulatory Framework with regard to Audit Committee is covered under -Clause 49 of the Listing Agreement and Section 292A of Companies Act, 1956.
- In terms of Clause 49-IV(G)(iii) of the Listing Agreement, a board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders/ Investors Grievance Committee'.
- Non-Mandatory Committees - Remuneration Committee, Nomination Committee, Corporate Governance Committee, Compliance Committee, Risk Management Committee, Ethics Committee, Strategies Committee, Capital Expenditure (Capex) Committee, etc.
- Remuneration Committee: Remuneration Committee or Compensation Committee as the name suggests is constituted by a company is to determine the remuneration packages of executive directors/ chief executive officers.
- Corporate Governance Committee: A company may constitute this committee to develop and recommend the board a set of corporate governance guidelines applicable to the company, implement policies and processes relating to corporate governance principles, to review, periodically, the corporate governance guidelines of the company.
- Corporate Compliance Committee: The primary objective of the Compliance Committee is to review, oversee, and monitor the Company's compliance with applicable legal and regulatory requirements, its policies, programs, and procedures to ensure compliance with relevant laws, its Code of Conduct, and other relevant standards.
- Risk Management Committee: A business is exposed to various kind of risk such as strategic risk, data security risk, fiduciary risk, credit risk, liquidity risk, reputational risk, environmental risk, competition risk, fraud risk, technological risk etc. A risk management Committee's role is to assist the Board in establishing risk management policy, overseeing and monitoring its implementation.

SELF TEST QUESTIONS

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

1. 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 –
 - 1 Board Composition
 - 2 Training of Directors
 - 3 Board Charter
 - 4 Lead Independent Director
 - 5 Board Evaluation

Lesson 6

Board Committees

LESSON OUTLINE

- Need and advantages of Committees Management
- Enhancing Effectiveness of Committees
- Mandatory committees:
 - Audit Committee
 - Nomination and Remuneration Committee
 - Stakeholders Relationship Committee
 - CSR Committee
- Non Mandatory Committee
 - Corporate Governance Committee
 - Regulatory, Compliance and Government Affairs Committee
 - Science Technology and Sustainability Committee
 - Risk Management Committee
- Other Committees
- 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. After this study lesson, students would be able to understand the effective company management through the delegation of power and responsibilities to the 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 Governmental 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 full board's time and allows 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 define with due care.

NEED AND ADVANTAGES OF COMMITTEES MANAGEMENT

Committees are a sub-set of the board, deriving their authority from the powers delegated to them by the board. Under section 177 of Companies Act, 2013, Board of Directors may delegate certain matters to the committees set up for the purpose. These committees are usually formed as a means of improving board effectiveness and efficiency in areas where more focused, specialized and technically oriented discussions are required. These committees prepare the groundwork for decision-making and report at the subsequent board meeting.

In the present day, the regulatory requirement is such that the composition of the board comprising executive directors and non-executive independent directors is relatively large in number. In such a situation it becomes at times practically difficult to convene board meetings which suit the convenience and other commitments of each director. By having smaller committees this aspect also gets addressed effectively.

Committees allow the board to:

- Handle a greater number of issues with greater efficiency by having experts focus on specific areas.
- Develop subject specific expertise on areas such as compliance management, risk management and financial reporting.
- Enhance the objectivity and independence of the Board's judgment.

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 tend 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.

Clause 49 of Listing Agreement (Annexure X) provides that minutes of meetings of audit committee and other committees of the board are to be placed before Board of Directors.

ENHANCING EFFECTIVENESS OF COMMITTEES

The following are the manifestations of an effective committee.

- Committee Charter defining purpose of the committee.
- Sensitivity to each other's needs; good communication among all members.
- Good preparation on 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.
- Minutes are complete and concise.
- 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

Clause 49 of Listing Agreement 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 reckoning the limit under this sub-clause, Chairmanship/membership of the Audit Committee and the Shareholders Grievance Committee alone shall be considered.

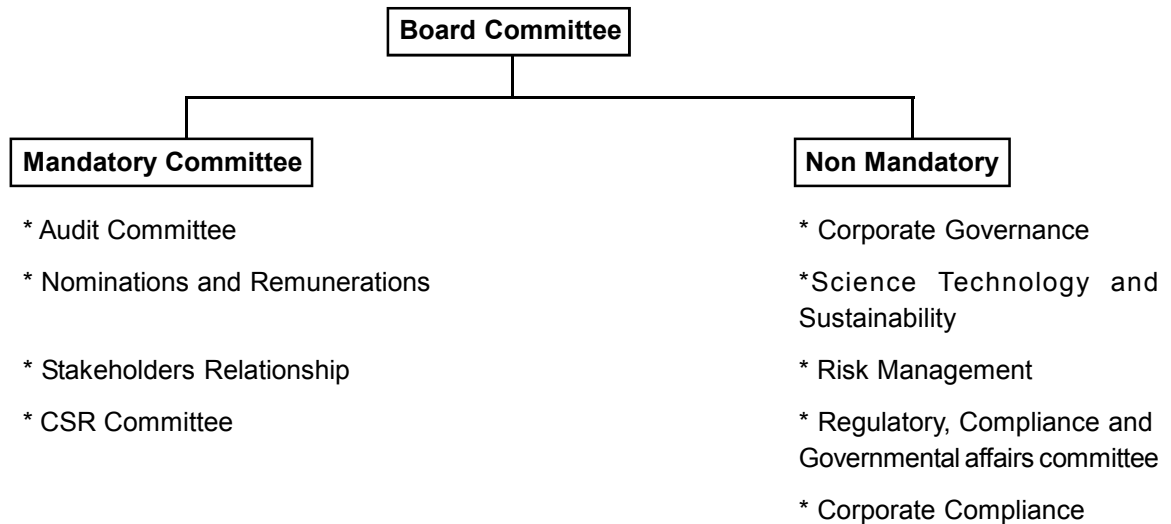
ICSI Recommendations to strengthen Corporate Governance suggests that the limits reckoned on membership/chairmanship of committees **should include all the committees** of listed companies on which such director is a member, whether such committees are mandatory or not. This should be on a 'comply' or '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
- Corporate Social Responsibility committee
- Stakeholders' Relationship committee

- Corporate Governance Committee
- Corporate Compliance Committee.



MANDATORY COMMITTEES

Clause 49 of the Listing Agreement applicable to all listed entities provides for constitution of mandatory committees.

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's qualifications and independence; and the performance of company's internal 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:

- Clause 49 of the Listing Agreement
- Section 177 of Companies Act, 2013

Clause 49

The regulatory framework, In terms of Clause 49 covers the following aspects:

- Composition
- Meetings
- Functions
 - Mandatory
 - Normal Role
- Powers

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. 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 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.

Explanation (j): The term “related party transactions” shall have the same meaning as provided in Clause 49(VII) of the Listing Agreement.

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.

Explanation - 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.

Comparison between Clause 49 and Section 177 of the Companies Act, 2013

Basis of difference	Requirements of Clause 49	Requirements of Section 177 of Companies Act
Applicability	The revised Clause 49 would be applicable to all listed companies with effect from October 01, 2014	The requirement of constitution of Audit Committee has been Limited to: <ul style="list-style-type: none"> (a) Every listed Companies; or (b) The following class of companies <ul style="list-style-type: none"> (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.
Composition	Minimum 3 directors as members. 2/3 of the members of audit committee shall be independent directors.	Comprising a minimum of 3 directors, with Independent Directors forming a majority. Majority of members of Audit Committee.
Qualification of committee members	All members shall be financially literate and at least one member shall have accounting expertise	Majority of members of Audit Committee including its Chairperson must have the ability to read and understand the financial statement.
Chairman	The Chairman shall be an independent director	Chairperson must have the ability to read and understand the financial statement.
Invitees	Auditors, internal auditor & director-finance or other executives may be present as invitees	Auditors, internal auditor & the director-finance <u>shall</u> attend & participate at meetings of Audit Committee but shall not vote
Secretary	Company secretary to be secretary of the Audit Committee	No corresponding requirement

Meeting	At least four times in a year and not more than four months shall elapse between two meetings	Nothing particular, it only states for periodical discussions with the auditors.
Quorum	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.	No corresponding requirement



Chairman of audit committee shall be the Chief Executive Officer True or False?

Key practical aspects relating to Audit Committee

- Audit Committee to be completely independent – Ideally only independent directors to be part of the audit committee
- Audit Committee charter to be formalized & disclosed to shareholders in the Annual Report
- Private meetings should be held between the members of the Audit Committee
- Annual self appraisal of performance
- Communication with Board

Audit Committee's primary responsibility

- Integrity of financial reports and compliance of Internal control systems
- Enterprise risk management
- Compliance with laws
- Whistle-blowing process
- Related party transactions
- Creditor obligation defaults
- Senior management compensation, expense reimbursements and assets use

Audit Committee's Enabling Responsibilities

- “Own” the relationship with both auditors- Internal & Statutory
- Determine appointment
- Periodic appraisal
- All commercial relationships
- Private meetings
- Ensure independence from management influence

- Planning & Structure of the audit
- Code of conduct quality & enforcement.

NOMINATION AND REMUNERATION COMMITTEE

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. The responsibilities of the Remuneration and Nomination Committee are defined in its policy document.

Clause 49 of Listing Agreement

In terms of the recently amended Clause 49 of the Listing Agreement which will take effect from October 1, 2014, companies are required to constitute Nomination and Remuneration Committee. The provisions with regard to Nomination and Remuneration Committee is 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' report .Be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and the shareholders.

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

The Stakeholders Relationship Committee – Clause 49

Clause 49 of Listing Agreement mandates 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.

The Stakeholders Relationship Committee – Under Companies Act, 2013

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. Who can attend the general meeting of the company on behalf of committee constituted under this section? 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 COMMITTEE

The evolution of corporate social responsibility in India refers to changes over time in India of the cultural norms of company's engagement of Corporate Social Responsibility (CSR), with CSR referring to way that businesses are managed to bring about an overall positive impact on the communities, cultures, societies and environments in which they operate. The fundamentals of CSR rest on the fact that not only public policy but even corporate should be responsible enough to address social issues. Thus companies should deal with the challenges and issues looked after to a certain extent by the states.

Among other countries, India has one of the richest traditions of CSR. Much has been done in recent years to make Indian entrepreneurs aware of social responsibility as an important segment of their business activity but CSR in India has yet to receive widespread recognition. If this goal has to be realised then the CSR approach of corporate has to be in line with their attitudes towards mainstream business- companies setting clear objectives, undertaking potential investments, measuring and reporting performance publicly.

As discussed above, CSR is not a new concept in India. Ever since their inception, large corporate houses in India have been involved in serving the community. Through donations and charity events, many other organizations have been doing their part for the society. The basic objective of CSR in these days is to maximize the company's overall impact on the society and stakeholders. CSR policies, practices and programs are being comprehensively integrated by an increasing number of companies throughout their business operations and processes.

A growing number of corporate feel that CSR is not just another form of indirect expense but is important for protecting the goodwill and reputation, defending attacks and increasing business competitiveness. Companies have specialised CSR teams that formulate policies, strategies and goals for their CSR programs and set aside budgets to fund them. These programs are often determined by social philosophy which have clear objectives and are well defined and are aligned with the mainstream business.

The programs are put into practice by the employees who are crucial to this process. CSR programs ranges from community development to development in education, environment and healthcare etc. Provision of improved

medical and sanitation facilities, building schools and houses, and empowering the villagers and in process making them more self-reliant by providing vocational training and a knowledge of business operations are the facilities that many companies focus on. Also corporate increasingly join hands with NGOs and use their expertise in devising programs which address wider social problems. One of the key changes in the Companies Act, 2013 is the introduction of a Corporate Social Responsibility section making India the first country to mandate CSR through a statutory provision. While CSR is not mandatory for companies, the rules are in line with the 'Comply or Explain' principle with penalties applicable only if an explanation is not offered.

The provisions of the Section may be summarized as under:

1. The Section applies to the following classes of companies during any financial year:
 - (i) Companies having Net Worth of rupees five hundred crore or more;
 - (ii) Companies having turnover of rupees one thousand crore or more;
 - (iii) Companies having Net Profit of rupees five crore or more.
2. The companies specified above shall constitute a Corporate Social Responsibility Committee (CSR Committee) of the Board.
3. The CSR Committee shall consist of three or more Directors, out of which at least one Director shall be an Independent Director.
4. After taking into account the recommendations of the CSR Committee, the Board shall approve the CSR Policy for the company.
5. The contents of the Policy shall be disclosed in the Board's report.
6. It shall also be placed on the Company's website, if any, in a manner to be prescribed by the Central Government.
7. The Board shall ensure that the activities as are included in the CSR Policy (from the activities as specified in Schedule VII) are undertaken by the Company.

The following additional features of the Section are relevant:

1. While spending the amount earmarked for CSR activities, the company shall give preference to the local area and areas around it where it operates;
2. If the Company fails to spend the amount, the Board shall specify the reasons for not spending the amount in the Board's Report.
3. The eligible companies are required to spend 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 CSR Policy. For this purpose, "Average Net Profit" shall be calculated in accordance with the provisions of Section 198 of the Companies Act, 2013.

NON-MANDATORY COMMITTEES

A company may have as many non-mandatory committees as it would require for efficient oversight of the company. We will discuss about the committees which are generally constituted by corporate.

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 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 principles, 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 is 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, programs, 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.

It consists of non-employee directors, determined to be "independent" under the listing standards of the New York Stock Exchange:

- Oversees the Company's non-financial compliance programs and systems with respect to legal and regulatory requirements.
- Oversees compliance with any ongoing Corporate Integrity Agreements or any similar undertakings by the Company with a government agency.

ICSI Recommendations to strengthen Corporate Governance framework suggests for constitution of Corporate Compliance Committee on mandatory basis in respect of all public limited companies having a paid-up capital of Rs.5 crore or more.

The charter of the committee may include:

- To oversee the Company's compliance efforts with respect to relevant Company policies, the Company's Code of Conduct, and other relevant laws and regulations and monitor the Company's efforts to implement legal obligations arising from agreements and other similar documents;
- To review the Company's overall compliance program 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 program;
- 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, programs 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, programs and practices on environment, health, safety and un—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 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. It is important for the company to have a structured framework to satisfy that it has sound policies, procedures and practices are 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 corporate governance 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 company
- 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.

The recently amended Clause 49 of the Listing Agreement requires as under:

- A. The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures.
- B. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.
- C. The company shall also 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 provisions of (C) above shall be applicable to top 100 listed companies by market capitalization as at the end of the immediate previous financial year

OTHER COMMITTEES

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 – Audit Committee, Nomination and Remuneration Committee, stakeholders Relationship committee, CSR Committee.
- The Regulatory Framework with regard to Audit Committee is covered under -Clause 49 of the Listing Agreement and Section 177 of Companies Act, 2013.
- In terms of Clause 49 –VIII(E)(4) of Listing Agreement 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.
- Non Mandatory 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.

Lesson 7

Corporate Governance and Shareholder Rights

LESSON OUTLINE

- Rights of Shareholders
- Challenges in Exercising Shareholders Rights
- Protection of Rights of Minority Shareholders and Related Party Transactions
- Shareholder Activism
- Role of Institutional Investors in Corporate Governance
- 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 and 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.

The Companies Act, 2013 facilitates various shareholders rights. Some of these provisions are notified and some are yet to be notified. Provisions relating to oppression and mismanagement, merger and amalgamation are not yet notified. However, the same has been discussed in this lesson for information of the student.

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

– Eliot Spitzer

INTRODUCTION

Protection of shareholder rights is sacrosanct for good corporate governance. It is one of the pillars of corporate governance. For the efficient functioning of the capital market, the fundamental requirement is that the investor rights are well protected. The Preamble to Securities and Exchange Board of India Act, 1992 reads as under:

“An Act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected there with or incidental thereto.”

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

In the Indian context, the SEBI Act, 1992, the various SEBI Regulations and Guidelines and the Companies Act, 2013 enables the empowerment of shareholder rights.

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

Shareholders generally enjoy the following types of rights:

- Voting rights on issues that affect the corporation as a whole
- Rights related to the assets of the corporation
- Rights related to the transfer of stock
- Rights to receive dividends as declared by the board of directors of the corporation
- Right to receive financial statements
- Rights to inspect the records and books of the corporation
- Rights to bring suit against the corporation for wrongful acts by the directors and officers of the corporation
- Rights to share in the proceeds recovered when the corporation liquidates its assets

The OECD Principles on Corporate Governance, which broadly recommends six principles. Recommends the following two principles with regard to shareholders:

- The corporate governance framework should protect and facilitate the exercise of shareholders' rights. (Principle II).
- 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 (Principle III).

The corporate governance framework should protect and facilitate the exercise of shareholders' rights. (Principle II)

This Principles propound basic shareholder rights should include the right to:

- (i) secure methods of ownership registration : that is mechanism whereby the names of the shareholders and their shareholdings are properly registered. Section 88 of the Companies Act, 2013 which requires companies to maintain a Register of members ensures this right.
- (ii) convey or transfer shares : similarly the laws should be in place for free transferability of shares. Section 56 of the Companies Act, 2013 with regard to transfer of shares ensures this right
- (iii) Shareholders should obtain relevant and material information on the corporation on a timely and regular basis. This right is enabled under the companies Act as well as the Listing Agreement, in case of listed companies.
- (iv) Shareholders should be empowered to participate and vote in general shareholder meetings.
- (iv) Shareholders should be empowered to elect and remove members of the board; and
- (v) shareholders will have a right to a share in the profits of the corporation.

It further provides that 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.

The Companies Act, 2013 requires that such businesses be approved by shareholders by special resolution. Further, Section 117 of the Companies Act, 2013 requires a listed public company that resolutions relating to certain businesses should be got passed only by postal ballot. This is to allow all the shareholders to have their say on important matters. The Postal Ballot Rules list out the businesses which may be passed by postal ballot.

The principles also recommend that shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and 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. Shareholders should have the opportunity to ask questions to the board. 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. 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.

Other Recommendations

- Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.
- Markets for corporate control should be allowed to function in an efficient and transparent manner.
- 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.
- Anti-take-over devices should not be used to shield management and the board from accountability. The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 cover these aspects.
 1. The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.

2. 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.
3. 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.
4. 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.

Shareholder rights enshrined in the Companies Act, 2013

These rights can be categorised as under:

- (1) Right to receive copies of the following documents from the company:
 - (i) Copies of Audited Financial statements (Section 136).
 - (ii) Report of the Cost Auditor, if so directed by the Government.
 - (iii) Contract for the appointment of the managing or whole time director (Section 190).
 - (iv) Notices of the general meetings of the company (Sections 101).

- (2) Right to inspect statutory registers/returns and get copies thereof on payment of prescribed fee.

The members have been given right to inspect the following registers etc.:

- (i) Debenture trust deed (Section 71);
- (ii) Register of Charges (Section 87);
- (iii) Register of Members, Debenture holders and Index Registers, Annual Returns (Section 94);
- (iv) Minutes Book of General Meetings (Section 119);
- (v) Register of Contracts (Section 189);
- (vi) Register of Directors' (Section 171);
- (vii) Register of Directors' and Key Managerial Personnel and their Shareholdings (Section 170);
- (viii) Copy of agreement of appointment of the managing or whole time director (Section 190).

The members can also get the copies of the aforesaid registers/returns on payment of prescribed fee except those of Register of Directors and Register of Directors' Shareholdings. Members can also get copies of memorandum and articles of association on payment of a fee of Re. One (Section 17).

- (3) Right to attend meetings of the shareholders and exercise voting rights at these meetings either personally or through proxy (Sections 96,100,105 and 107).

- (4) Other rights.

Over and above the rights enumerated at Item Nos. 1 to 3 above, the members have the following rights:

- (a) To receive share certificates as title of their holdings [Section 46 read with the Companies (Issue of Share Certificates) Rules, 1960].
- (b) To transfer shares (Sections 44 and 56 and Articles).
- (c) To resist and safeguard against increase in his liability without his written consent.

- (d) To receive dividend when declared.
- (e) To have rights shares (Section 62).
- (f) To appoint directors (Section 152).
- (g) To share the surplus assets on winding up (Section 320).
- (h) Right of dissentient shareholders to apply to court (Section 48).
- (i) Right to make application collectively to the Tribunal for oppression and mismanagement (Sections 241 and 242). Right of Nomination.
- (j) Section 47 of the Act provides that every member of a public company limited by shares, holding equity shares, shall have votes in proportion to his share of the paid-up equity share capital of the company.
- (k) Preference shareholders ordinarily vote only on matters directly relating to rights attached to preference share capital. A resolution for winding up of the company or for the reduction of the share capital, will be deemed to affect directly the rights attached to preference share and so they can vote on such resolutions.
- (l) Section 48 of the Companies Act, 2013 lays down that the rights attached to the shares of any class can be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of the class. Further, the variation of rights of shareholders can be effected only:
 - (i) If provision with respect to such variation is contained in the Memorandum or Articles of association of the company; or
 - (ii) In the absence of any such provision in a Memorandum or Articles of association of the company, if such variation is not prohibited by the terms of issue of the shares of that class.
- (m) Section 48 of the Companies Act, 2013 confers certain rights upon the dissentient shareholders. According to this section, where the rights of any class of shares are varied, the holders of not less than ten per cent of the shares of that class, being persons who did not consent to or vote in favour of the resolution for the variation, can apply to the Tribunal to have the variation cancelled. Where any such application is made to the Tribunal, the variation will not be effective unless and until it is confirmed by the Tribunal.

SOME OF THE OTHER IMPORTANT PROVISIONS RELATING TO SHAREHOLDERS RIGHTS ENshrined IN THE COMPANIES ACT, 2013 ARE AS UNDER*

Power and duty to acquire shares of shareholders dissenting from scheme or contract approved by majority

Where a scheme or contract involving the transfer of shares or its class in a company to another company has, within four months after the making of the offer in that behalf by the transferee company, been approved by the holders of not less than nine-tenths in value of the shares whose transfer is involved, the transferee company may, at any time within two months after the expiry of the said four months, give notice to any dissenting shareholder, that it desires to acquire his shares; and when such a notice is given, the transferee company shall,

*yet to be notified.

unless, on an application made by the dissenting shareholder within one month from the date on which the notice was given, unless the CLB/Tribunal thinks fit to order otherwise, be entitled and bound to acquire those shares.

“dissenting shareholder” includes a share-holder who has not assented to the scheme or contract and any shareholder who has failed or refused to transfer his shares to the transferee company in accordance with the scheme or contract;

Application to Tribunal for relief in case of oppression

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.

If the Tribunal is of opinion that the company’s affairs are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members; and that to wind up the company would unfairly prejudice such member or members but that otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up; Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

Application to Tribunal for relief in cases of mismanagement

Any members of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or to the interests of the company; or that a material change of the company has taken place in the management or control of the company, whether by an alteration in its Board of directors or manager or in the ownership of the company’s shares, and that by reason of such change, it is likely that the affairs of the company [will be conducted in a manner prejudicial to public interest or] in a manner prejudicial to the interests of the company; may apply to the Tribunal for an order.

If Tribunal is of opinion that the affairs of the company are being conducted as aforesaid the Tribunal may, with a view to bringing to an end or preventing the matters complained of, make such order as it thinks fit.

The following persons have a right to apply under the above sections:

- (i) in the case of a company having a share capital, not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one-tenth of the issued share capital of the company, provided that the applicant or applicants have paid all calls and other sums due on their shares;
- (ii) in the case of a company not having a share capital, not less than one-fifth of the total number of its members.

The Central Government may, if in its opinion circumstances exist which make it just and equitable so to do, authorise any member or members of the company to apply to the Tribunal under section 397 or 398, notwithstanding the requirements of such number of members are not fulfilled.

Pending the making by it of a final order the Tribunal may, on the application of any party to the proceeding, make any interim order which it thinks fit for regulating the conduct of the company’s affairs, upon such terms and conditions as appear to it to be just and equitable.

Power and duty to acquire shares of shareholders dissenting from the scheme or contract approved by the majority

As per section 235(1) of Companies Act 2013, where a scheme or contract involving the transfer of shares or any class of shares in a company (the transferor company) to another company (the transferee company) has, within four months after making of an offer in that behalf by the transferee company, been approved by the holders of not less than nine-tenths in value of the shares whose transfer is involved, other than shares already held at the date of the offer by, or by a nominee of the transferee company or its subsidiary companies, the transferee company may, at any time within two months after the expiry of the said four months, give notice in the prescribed manner to any dissenting shareholder that it desires to acquire his shares.

As per section 235 (2) ,where a notice under sub-section (1) is given, the transferee company shall, unless on an application made by the dissenting shareholder to the Tribunal, within one month from the date on which the notice was given and the Tribunal thinks fit to order otherwise , be entitled to and bound to acquire those shares on the terms on which, under the scheme or contract, the shares of the approving shareholders are to be transferred to the transferee company.

Application to Tribunal for relief in case of oppression and mismanagement

As per section 241 of The Companies Act, 2013, any member of a company who complains that—

- (a) the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to him or any other member or members or in a manner prejudicial to the interests of the company; or
- (b) the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by an alteration in the Board of Directors, or manager, or in the ownership of the company's shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members, may apply to the Tribunal, provided such member has a right to apply under section 244.

(2) The Central Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest, it may itself apply to the Tribunal for an order.

Section 242 provides that if, on any application made under section 241, the Tribunal is of the opinion—

- (a) that the company's affairs have been or are being conducted in a manner prejudicial or oppressive to any member or members or prejudicial to public interest or in a manner prejudicial to the interests of the company; and
- (b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up, the Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

As per section 244, the following members of a company shall have the right to apply under section 241, namely:—

- (a) in the case of a company having a share capital, not less than one hundred members of the company

or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

- (b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members:

Provided that the Tribunal may, on an application made to it in this behalf, waive all or any of the requirements specified in clause (a) or clause (b) so as to enable the members to apply under section 241.

Explanation.— For the purposes of this sub-section, where any share or shares are held by two or more persons jointly, they shall be counted only as one member.

Where any members of a company are entitled to make an application under subsection (1), any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them.

Section 245 of Companies Act, 2013, provides the following regarding Class Action Suits:

(yet to be notified)

- (1) Such number of member or members, depositor or depositors or any class of them, as the case may be, as are indicated in sub-section (2) may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the members or depositors for seeking all or any of the following orders, namely:—
- (a) to restrain the company from committing an act which is *ultra vires* the articles or memorandum of the company;
 - (b) to restrain the company from committing breach of any provision of the company's memorandum or articles;
 - (c) to declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by mis-statement to the members or depositors;
 - (d) to restrain the company and its directors from acting on such resolution;
 - (e) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;
 - (f) to restrain the company from taking action contrary to any resolution passed by the members;
 - (g) to claim damages or compensation or demand any other suitable action from or against—
 - (h) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;
 - (i) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or
 - (j) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;
 - (k) to seek any other remedy as the Tribunal may deem fit.

- (2) Where the members or depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner.
- (3) (i) The requisite number of members provided in sub-section (1) shall be as under:—
- (a) in the case of a company having a share capital, not less than one hundred members of the company or not less than such percentage of the total number of its members as may be prescribed, whichever is less, or any member or members holding not less than such percentage of the issued share capital of the company as may be prescribed, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;
- (b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members.
- (ii) The requisite number of depositors provided in sub-section (1) shall not be less than one hundred depositors or not less than such percentage of the total number of depositors as may be prescribed, whichever is less, or any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.
- (4) In considering an application under sub-section (1), the Tribunal shall take into account, in particular—
- (a) whether the member or depositor is acting in good faith in making the application for seeking an order;
- (b) any evidence before it as to the involvement of any person other than directors or officers of the company on any of the matters provided in clauses (a) to (f) of subsection (1);
- (c) whether the cause of action is one which the member or depositor could pursue in his own right rather than through an order under this section;
- (d) any evidence before it as to the views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this section;
- (e) where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—
- (i) authorised by the company before it occurs; or
- (ii) ratified by the company after it occurs;
- (f) where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company.
- (5) If an application filed under sub-section (1) is admitted, then the Tribunal shall have regard to the following, namely:—
- (a) public notice shall be served on admission of the application to all the members or depositors of the class in such manner as may be prescribed;
- (b) all similar applications prevalent in any jurisdiction should be consolidated into a single application and the class members or depositors should be allowed to choose the lead applicant and in the event the members or depositors of the class are unable to come to a consensus, the Tribunal shall have the power to appoint a lead applicant, who shall be in charge of the proceedings from the applicant's side;
- (c) two class action applications for the same cause of action shall not be allowed;

- (d) the cost or expenses connected with the application for class action shall be defrayed by the company or any other person responsible for any oppressive act.
- (6) Any order passed by the Tribunal shall be binding on the company and all its members, depositors and auditor including audit firm or expert or consultant or advisor or any other person associated with the company.
- (7) Any company which fails to comply with an order passed by the Tribunal under this section shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.
- (8) Where any application filed before the Tribunal is found to be frivolous or vexatious, it shall, for reasons to be recorded in writing, reject the application and make an order that the applicant shall pay to the opposite party such cost, not exceeding one lakh rupees, as may be specified in the order.
- (9) Nothing contained in this section shall apply to a banking company.
- (10) Subject to the compliance of this section, an application may be filed or any other action may be taken under this section by any person, group of persons or any association of persons representing the persons affected by any act or omission, specified in sub-section (1).

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;
- 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 1992 and amended in 2002. 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 Sytem (SCORES)

Insider Trading

Insider Trading, in general parlance, means dealing in the securities of a company based on certain information which is not publicly disclosed (the recipient has access to such information due to his proximity to the source) and such information is likely to have an influence on the price of the securities.

The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992, say, “Insider” is any person, who is or was connected with the company, and who is reasonably expected to have access to unpublished price-sensitive information about the stock of that particular company, or who has access to such unpublished price sensitive information.

Information that could be price sensitive includes

- Periodical financial results of a company,
- Intended declaration of dividend,
- Issue or buyback of securities,
- any major expansion plans or execution of new projects, amalgamation, merger, takeovers, disposal of the whole or substantial part of the undertaking and any other significant changes in policies, plans or operations of the company.

Investor Education & Protection Fund

Investor Education and Protection Fund (IEPF) is established under section 205C of Companies Act. Since the relevant provisions under new act are not yet notified. 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

- Deliberate misstatement in offer statements to investors
- Price manipulations
- Insider trading.

SEBI has issued many guidelines and regulations to regulate the capital market and to protect the investors. Some of the guidelines are:

- SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009;
- SEBI (Ombudsman) Regulation 2003 – designed to redress the investor’s grievance against listed companies or intermediaries or both for amicable settlement;
- SEBI (Prohibition of fraudulent and unfair Trade Practices relating to securities market) Regulations 2003 – to prohibit any fraudulent and unfair Trade Practices relating to securities market;
- SEBI (Prohibition of Insider Trading) Regulations 1992 and amended in 2002. 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 Sytem (SCORES)

Insider Trading

Insider Trading, in general parlance, means dealing in the securities of a company based on certain information which is not publicly disclosed (the recipient has access to such information due to his proximity to the source) and such information is likely to have an influence on the price of the securities.

The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992, say, “Insider” is any person, who is or was connected with the company, and who is reasonably expected to have access to unpublished price-sensitive information about the stock of that particular company, or who has access to such unpublished price sensitive information.

Information that could be price sensitive includes

- Periodical financial results of a company,
- Intended declaration of dividend,
- Issue or buyback of securities,
- any major expansion plans or execution of new projects, amalgamation, merger, takeovers, disposal of the whole or substantial part of the undertaking and any other significant changes in policies, plans or operations of the company.

Investor Education & Protection Fund

Investor Education and Protection Fund (IEPF) is established under section 205C of Companies Act. Since the relevant provisions under new act are not yet notified. 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.

Modus Operandi

Insider buys the stock (he might also already own it). He then releases price-sensitive information to a small group of people close to him, who buy the stock based on it, and spread the information further. This results in an increase in volumes and prices of the stock. The inside information has now become known to a larger group of people which further pushes up volumes and prices of the stock.

After a certain price has been reached, which the insider knows about, he exits, as do the ones close to him, and the stock's price falls. Those who had inside information are safe while the ordinary retail investor is stuck holding a white elephant as, in many cases, the 'tip' reaches him only when the stock is already on a boil.

The regular investor gets on the bandwagon rather late in the day as he is away from the buzz with no direct connection to the 'real' source. He buys the overvalued stock due to imbalance in the information flow.

However, insider trading isn't always illegal. Trading by a company insider in its shares is not violation per se and is legal. What is illegal is the trading by an insider on the basis of unpublished price-sensitive information. Insider trading violations may also include 'tipping' such information and the person using it.

Rules against insider trading on material non-public information exist in most jurisdictions around the world, though the details and the efforts to enforce them vary considerably. The United States is generally viewed as having the strictest laws against illegal insider trading, and makes the most serious efforts to enforce them.

A recent case in the United States of America serves as a good case study on Insider Trading

Rajratnam and Rajat Gupta Case

Rajaratnam was the Sri-Lankan manager of the hedge fund Galleon Group, which managed \$6.5 billion at its height.

Rajat Gupta is a former director at Goldman Sachs and head of McKinsey consulting. He also served on the board of Procter & Gamble.

Warren Buffet is the CEO of Berkshire Hathaway, an investment company.

Facts and Claims

Facts

On September 23, 2008, Warren Buffet agreed to pay \$5 billion for preferred shares of Goldman Sachs.

This information was not announced until 6 p.m., after the NYSE closed on that day.

Before the announcement, Raj Rajaratnam bought 175,000 shares of Goldman Sachs.

The next day, by which time the infusion was public knowledge, Rajaratnam sold his shares, for a profit of \$900,000.

In the same period of time financial stocks as a whole fell.

Claims

Rajat Gupta had called Rajaratnam immediately after the board meeting at which Warren Buffet's infusion had been announced, and told him of the money Goldman expected to receive.

This information was material to the price of Goldman stock, thus inciting Rajaratnam to make the trade, something he would otherwise not have done.

Conviction

Rajaratnam was sentenced to 11 years in prison and fined a criminal and civil penalty of over \$150 million combined.

Rajat Gupta was convicted on insider trading charges stemming from the Raj Rajaratnam/Galleon Group insider trading cases on four criminal felony counts of conspiracy and securities fraud. He was sentenced to two years in prison, an additional year on supervised release and ordered to pay \$5 million in fines

Indian Scenario

Tata Finance Limited

SEBI has passed an order dated January 11, 2008 in the matter of M/s. Tata Finance Limited (TFL) restraining Mr. D.S. Pendse, Mrs. Anuradha Pendse, Dr. Anjali Beke and M/s. Nalini Properties Pvt. Ltd. from accessing the securities market and prohibiting them from buying, selling or otherwise dealing or associating with the securities market in any manner whatsoever, for a period of five years.

Upon receiving a complaint from TFL, a copy of which was also received from Joint Parliamentary Committee, SEBI initiated an investigation *inter alia* into the alleged insider trading by Mr. Pendse and his relatives/associates/friends.

It was alleged that Mrs. Anuradha Pendse, Dr. Anjali Beke and Nalini Properties (P) Ltd. had sold shares of TFL on 28th March 2001 on the basis of a unpublished price sensitive information relating to the financial position of TFL which was not in public domain. The unpublished price sensitive information was alleged to have been provided to them by Mr. Dilip Pendse who at the relevant point of time, was the Managing Director of TFL. The price sensitive information was pertaining to the loss of Rs.79.37 crores suffered by Nishkalp Investment and Trading Co Ltd, a wholly owned subsidiary of TFL. This information was made public only on 30th April 2001. Mr. Dilip Pendse, besides being MD of TFL was also the Director of Nishkalp at the relevant time. It is alleged that Mr. Pendse was aware of the poor financial position of TFL on account of the losses incurred by Nishkalp before the information was made public on 30.04.2001. Accordingly, his associates/relatives sold 2,90,000 shares of TFL during March 2001, before the information became public. 40,000 shares of TFL were sold by Mrs. Anuradha Pendse and Nalini Properties, Dr. Anjali Beke a close friend and associate of Mr. Pendse for several years, also sold 2,30,000 shares in the name of Anjudi Properties & Investment Pvt. Ltd., a company associated/ connected with Mr. Pendse and controlled by Dr. Anjali Beke and her husband Dr. Beke. It was alleged that on account of the sale, unjust profit accrued to the entites.

IFCI

Take the case of IFCI. The stock had been on fire since early January 2007. It gained almost 53 per cent in eight trading sessions from Rs 13.45 before the announcement of its 7-per cent stake sale in NSE was made in January 2007.

The stock also gained 30 per cent in 12 sessions before the announcement to appoint Ernst & Young for

advising the company on induction of a strategic investor in the company was made in March 2007. From this level, the run up in the stock has been over 210 per cent.

While it is not possible to say that insider trading took place in this case, little else explains the share price movement. The expected strategic sale was called off in December 2007, and the stock shed almost 23 per cent in one session. Investors who got on the bandwagon at around Rs 70-74 in early September 2007 and did not sell by this time, would have lost all their gains.

HLL- BBLIL

The misuse is subject to varying interpretations. The insider-trading allegation against Hindustan Lever (HLL) for purchasing eight lakh shares of Brooke Bond Lipton India (BBLIL) from Unit Trust of India a month before the merger of the two companies was announced is a case in point.

Both Hindustan Lever Ltd and Brooke Bond were subsidiaries of Uniliver. As a part of the merger scheme of the two companies and also to continue to maintain its majority holding. Uniliver ordered HLL to buy 8 lakh shares of BB from Unit Trust of India (UTI). HLL did so by paying 10% premium over prevailing market price. After investigation, a case of insider trading was brought against Hindustan Lever and its directors. SEBI, did not impose penalty on HLL or its director for insider trading, but ordered prosecution of the directors, besides ordering payment of compensation to UTI of Rs. 3.04 crores. In appeal, the tribunal upheld the finding of insider trading as HLL was a deemed connected person and also had price sensitive information which would have affected the market price of shares. However, the tribunal found favour with HLL's argument that the information it possessed was published, even though not confirmed or authenticated by the company. In support thereof, it relied on several news reports prior to the date of merger. Further, the fact that UTI had continued to sell BB shares at more or less the price given by HLL showed that the merger had not resulted in the either loss to UTI, or gain to HLL. On the issue of awarding compensation, the order of the SEBI was held to be without jurisdiction. Hence the appeal claiming enhanced compensation was dismissed. As regards the direction to prosecute the directors of HLL, the tribunal felt that the SEBI had not established in its order the gravity of the case, so as to merit prosecution. However, the Tribunal left it open to SEBI to commence adjudication proceeding against the directors under section 15G of the Act. [Hindustan Lever Ltd. v. SEBI, (1993) 3 COMP U 473: (1998) (18) SCL 311 (SAT)]. It is submitted that in this case, HLL got away with its skin in teeth more due to defective statutory provision and also due to some publications prior to acquisition. Otherwise, the transaction had all the hallmark of advantage to HLL in the process. Be that as it may, the last observation which gives liberty to commence adjudication proceeding against the directors is inconsistent with the general tenor of the order, which exonerates HLL. There was no reason to leave the field open for proceeding against directors.

PROTECTION OF RIGHTS OF MINORITY SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

Accounting Standard 18 defines Related Party and Related Party Transactions as under:

1. 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.
2. Related party transaction - a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

Related Party Transaction is a critical issue in any organization. They are not necessarily wrong, in fact transactions with related parties happen across all jurisdictions and in the normal course of business. However, because of their delicate nature and the risk of abuse or fraud, they must be carefully scrutinized and fully disclosed.

The Asian Corporate Governance Association's white paper on Corporate Governance in India alludes that according to domestic Indian fund managers, typical transactions that listed companies engage in include:

Spinning off valuable assets from listed companies to unlisted private entities for the benefit of promoters.

Spinning off investments in group companies to a holding company, valuing the investments at a large discount to fair value, then buying back the shares of the holding company from the market.

Shifting new business to unlisted private entities and letting an affiliated listed company pay for branding and distribution costs.

It is very apparent that these types of transactions are detrimental to the interests of the minority shareholders. Therefore related party transactions need to be monitored properly to prevent abuse.

Role of Audit Committee

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.

As per Clause 49(VII) of Listing Agreement, provides following with regard to Related Party Transactions:

- A. A related party transaction is a transfer of resources, services or obligations between a company and a related party, regardless of whether a price is charged.
- B. A 'related party' is a person or entity that is related to the company. Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions.
- C. The company shall formulate a policy on materiality of related party transactions and also on dealing with Related Party Transactions.

Provided that a transaction with a related party shall be considered material if the transaction / transactions to be entered into individually or taken together with previous transactions during a financial year, exceeds five percent of the annual turnover or twenty percent of the net worth of the company as per the last audited financial statements of the company, whichever is higher.

- D. All Related Party Transactions shall require prior approval of the Audit Committee.
- E. All material Related Party Transactions shall require approval of the shareholders through special resolution and the related parties shall abstain from voting on such resolutions.

Further Clause 49(VIII)(A) of Listing Agreement provides for disclosures related to Related Party Transactions in the following manner:

1. Details of all material transactions with related parties shall be disclosed quarterly along with the compliance report on corporate governance.
2. The company shall disclose the policy on dealing with Related Party Transactions on its website and also in the Annual Report.

Related party transactions are many times made through complex transactions between the company and its managers, directors, subsidiaries, and major shareholders, it is hard for outsiders to discover questionable or fraudulent transactions, if any. Therefore it becomes imperative for the Internal Control Processes within the company to be robust enough to identify the related party transactions, determine whether they are at arm's length and that these are not used as a means of manipulation.

The audit committee can ensure that adequate checks and balances are placed to ensure that minimum conflict of interest situation arises. Some of the basic measures that can be adopted is to have clear and well laid down policies with regard to purchases, engagement of vendors, appointments at key levels, open bidding for material contracts and a well functioning whistle-blower mechanism.

Role of Internal Auditors

The internal auditors have a key role to play in actually ensuring that the systems of checks and balances are functioning effectively. The internal auditor should directly report to the audit committee. An issue of debate with regard to the internal auditor is whether the internal audit function should be assigned to an external audit firm or can be carried out within the company.

In India, Clause 49 requires that the audit committee review, with management, the performance of internal auditors, as well as the adequacy of the internal audit function, if any, including the structure of the internal audit department, reporting structure coverage and the frequency of internal audit. The audit committee should also review the internal audit reports relating to internal control weaknesses and discuss significant findings with the internal auditors. Currently, the appointment, removal and terms of remuneration of the chief internal auditor should also be reviewed by the audit committee.

Due Diligence Process

While, the internal audit process is likely to reveal the occurrence of questionable transactions after they have occurred, a system of due diligence will help curbing abusive related party transactions from occurring.

Audit committee should seek a due diligence report with regard to all proposed material transactions which should highlight potential conflict of interest. In this regard companies should have well articulated policies specifying that transactions beyond certain threshold limits and transactions of certain nature would require a pre-clearance from the audit committee.

Role of Independent Directors

The independent directors have a pivotal role to play in monitoring related party transactions. This is one of the key recommendations of the OECD Guide to Fighting Abusive Related Party Transactions Recommendation 5 states as under:

Independent directors should play a central role in monitoring related party transactions, such as designing board approval procedures, conducting investigations and having the possibility for obtaining advice from independent experts. Their role should be supported by the policy framework.

Independent directors play a crucial role in monitoring abusive related party transactions. While all directors are required to discharge fiduciary duties to all shareholders, inviting directors with a conflict of interest in discussions on related party transactions may be counter-productive. 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. Although the OECD Guide has recommended the threshold approach to disclosure and approval at the shareholder level, it suggests that all related party transactions require board oversight (with interested parties abstaining from both discussions or voting on the transaction).

The OECD Guide on Fighting abusive related party transactions recommends that only non-conflicted directors discuss and decide on a related party transaction, and this could be included in the company's policy about a board approval procedure. A number of jurisdictions currently enforce similar requirements including India which requires as part of the company's Listing Agreement that the audit committee approve all related party transactions and that the firm disclose "materially significant" related party transactions to shareholders. Moreover, the Guide recommends that, where transactions require shareholder approval, independent directors may wish to:

- retain an independent expert to offer professional advice to independent directors on the fairness of the transaction; and
- make a recommendation to shareholders.

Whistle-blower mechanism

The OECD Guide describes that an effective ‘whistle blower’ mechanism may be established by management as an internal control mechanism, assessed by internal auditors. Such mechanisms are in many cases under the remit of the audit committee, and the internal auditor might assess the robustness of such mechanisms. In particular, internal auditors might consider whether employees are able to anonymously relate concerns over transactions. In some cases whistle-blower mechanisms and procedures are in place, but fall down on fundamental flaws; they may request the whistle-blowers to identify themselves, for example, or may route the whistle-blower hotline direct to the CEO and/or Chairman (who may be the counter-party of concern). Many effective mechanisms make use of external bodies, ensuring anonymity and allowing for an uninhibited disclosure. Regulators and legislators may seek to provide statutory protection for whistle blowers, protecting these parties from court action where a report was made in good faith.

In India, Clause 49 of the Listing Agreement prescribes as a mandatory requirement that companies shall establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy. This mechanism provides for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization. The audit committee is tasked to review the functioning of the Whistle Blower mechanism. Further, in the Corporate Governance Report, the company shall disclose the whistle Blower policy and affirmation that no personnel has been denied access to the audit committee.

Disclosure

The OECD Guide provides that the legal and regulatory framework for “related party transactions” should provide appropriate and effective threshold-based tiers, referring to materiality for disclosure and shareholders’ approval and/or board approval of related party transactions according to the risk of potential abuse. It should also take into account regulatory efficiency, weighing the potential cost and benefits.

The Board is duty bound to have control over Related Party and Related Party Transactions. It is the responsibility of the Board to ensure that such transactions are just, fair and total in the interests of the company.

In terms of the Companies Act, 2013 every director of a company must disclose the nature of his concern or interest in any transaction of the company at a meeting of the Board of Directors. In the case of a publicly owned company a directed interested or concerned in any contract or arrangement entered into or to be entered in to by the company is also prohibited from voting on the resolution brought up at the Board meeting for the approval of the contract. He has to abstain himself from the discussion on the resolution [Section 300].

Section 184 of the Companies Act, 2013 imposes a specific duty on every director to disclose his interest to the full Board.

Since the Board may be a varying body, the section requires a fresh notice of disclosure to be given at the end of each financial year. By virtue of section 167(1) (d) of the Companies Act, 2013, if a director fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested; in contravention of the provisions of section 184, his office will *ipso facto* become vacated. Further, there is also penalty payable. The provisions are founded on the principle that a director is precluded from dealing on behalf of the company as himself and from entering into engagements in which he has a personal interest conflicting or which possibly may conflict with the interest of those with whom he is bound by fiduciary duty. A director occupies a fiduciary position in relation to a company and he must act *bona fide* in the interest of the company. If a director makes a contract with the company and does not disclose his interest, he will be committing breach of trust, *Yashovardhan Saboo v. Groz-Beckert Saboo Ltd.*, (1995) 83 Com Cases 371 at p.413 (CLB).

The section is so worded that any conflict of personal interest of the director with his duties to the company as

its director will have to be disclosed. To emphasise this point, the relevant sub-section 299 is reproduced below:

Section 184 provides for “disclosure of interest by director”, according to it:-

- (1) Every 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 disclosures already made, then at the first Board meeting held after such change, disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding, in such manner as may be prescribed.
- (2) Every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into:
 - (a) with a body corporate in which such director or such director in association with any other director, holds more than two per cent. shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate; or
 - (b) with a firm or other entity in which, such director is a partner, owner or member, as the case may be, shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting:

Provided that where any director who is not so concerned or interested at the time of entering into such contract or arrangement, he shall, if he becomes concerned or interested after the contract or arrangement is entered into, disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested.

Further, any contract or arrangement entered into by the company without disclosure or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company. Moreover, in case of non compliance to the provisions, director shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to one lakh rupees, or with both.

Section 188 prohibits company to enter into any contract or arrangement with a related party except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as may be prescribed. These are applicable in case of:

- (a) sale, purchase or supply of any goods or materials;
- (b) selling or otherwise disposing of, or buying, property of any kind;
- (c) leasing of property of any kind;
- (d) availing or rendering of any services;
- (e) appointment of any agent for purchase or sale of goods, materials, services or property;
- (f) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and
- (g) underwriting the subscription of any securities or derivatives thereof, of the company:

Provided that no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions not exceeding such sums, as may be prescribed, shall be entered into except with the prior approval of the company by a special resolution:

Provided further that no member of the company shall vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party:

These provisions are however not applicable to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis.

Any director or any other employee of a company, who had entered into or authorized the contract or arrangement in violation of the provisions of this section shall—

- (i) in case of listed company, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both; and
- (ii) in case of any other company, be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.

Role of independent Auditors

The OECD Guide to fight abusive related party transactions recommends that the external auditor should be independent, competent and qualified in order to provide an assurance to the board and shareholders that material information concerning related party transactions is fairly disclosed and alert them to any significant concerns with respect to internal control. The policy framework should support this role effectively.

The Guide further elaborates that it is in the interests of market operators, regulators, companies, and auditors themselves that auditors are of a high quality, and that information on auditor quality is communicated to the market.

Disinterested shareholders' approval

The OECD Guide recommends - Where reliance is placed on shareholders' approval, a voting system should be established with a majority of disinterested shareholders for the approval of related party transactions at Shareholders Meetings.

This concern is not presently addressed in the Indian context but is prevalent in many jurisdictions is the voting by only disinterested shareholders.

Role of Institutional Investors

In conclusion what can be said is that the fight against abusive related party transaction is as much a governance issue as it is a gearing up the internal control processes within an organization. Company's sustainability hinges on the effective processes that the company adopts to curb abusive related party transactions. In addition to the regulators, independent directors, the internal auditors and the statutory auditors, the minority shareholders, institutional investors have a significant role to play in this regard. Institutional investors should exercise their voting rights with due care and question the company on related party transactions which may be in conflict with the interests of the company. Similarly the minority shareholders should exercise their voting rights judiciously and be vigilant. They should respond to resolutions sought to be passed by postal ballot and request companies to facilitate e-voting at general meetings.

SHAREHOLDER 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.

A management that knows that it will be questioned and held responsible for its actions, is always on its feet.

The corporate crisis that looms today - shareholder activism - is with different actors but the same stories. In the 90's it was hostile takeovers. Today it is hostile hedge funds frustrated with performance and employing new strategies to improve overall returns. Ironically, shorter term investors that once "voted with their feet" are now taking the long road of shareholder activism.

History of Shareholder Activism

Shareholder activism can be traced back 80 years when Henry Ford chose to cancel a special dividend and instead spend the money on advancing social objectives. The court ultimately sided with dissented shareholders, reinstated the dividend, sparking a new paradigm in shareholder activism.

In the late 1980's, shareholder activism took a more aggressive turn with corporate raiders like Paul Getty. Shareholders took on management, The New Crisis: Shareholder Activism Ashton Partners engaging in hostile takeovers and leveraged-buyouts to gain control of undervalued and underperforming companies.

In the 1990's shareholder activism found mainstream pension fund managers like CalPERS pushing for the repeal of staggered boards and poison pills. These players used a form of "quiet" activism – favoring abstentions and withholding votes for important proxy issues – as a way to influence management and Board decisions.

The purpose of shareholder activism is to

- Provide an overview of shareholder activist, and how it may influence a company's behaviour,
- Identify what options are available for shareholders wishing to pursue an activist agenda, and
- Consider the legal framework in which UK public companies must operate when faced with shareholder activism.

Shareholder activism can be exercised through **proxy battles, publicity campaigns, shareholder resolutions, litigation and negotiations** with management. For example,

- Shareholder activism played a major role in eradicating apartheid in South Africa through divestment.
- Shareholders have also influenced the phasing out of polystyrene products at McDonalds.
- More recently, shareholders were able to bring public pressure and media attention on Home Depot to stop the use of wood from environmentally sensitive areas.

The shareholder activism means

- Establishing dialogue with the management on issues that concern
- Influencing the corporate culture.
- Using the corporate democracy provided by law.
- Increasing general awareness on social and human rights issues concerning the organization.

Internet and mass media are effective tools in building up pressure on the management.

Shareholder activism often highlights differences in strategy or poor communication. In numerous activist situations companies believing they've told one story, and the investment community hearing another, or nothing at all. Inconsistency in messaging and lack of information breed investor discontent, and ultimately shareholder activism. If ignored long enough, the situation comes to a breaking point where activist investors choose a drastic approach.

INVESTORS FORCE ETHICAL ISSUES ON TESCO'S AGENDA

AGM 29 June 2007- TESCO

Tesco a UK based Supermarket Chain Company faced an unprecedented revolt over the meagre wages it pays workers in the developing world to supply its supermarkets with everything from cheap clothing to fruit.

Shareholders at the company's annual meeting in London also voiced their anger at a controversial pay scheme for chief executive Sir Terry Leahy, which could see him pocket over £11 million if Tesco's expansion into the US market succeeded.

More than one-in-six shareholders failed to back Sir Terry's new pay scheme, while almost 20% of shareholders refused to reject a resolution calling for Tesco to pay workers in the developing world a "living wage".

The latter resolution was tabled by Ben Birnberg, a retired solicitor. It was the first time an independent shareholder had got a motion onto the table at a Tesco AGM, and it was an important piece of shareholder activism. The board of Tesco called on shareholders to reject it saying that the company was already taking steps to ensure its suppliers treat workers properly.

But Mr Birnberg told the meeting that "the irony of the board recommending that shareholders vote against our resolution to increase the meagre pay of its outsourced workers ... while at the same time provocatively recommending that shareholders vote for incentive plans which will augment the already absurdly generous remuneration packages for its top executives ... may be lost on the board but it is certainly not lost on this shareholder or more to the point on the public at large".

"There is nothing that lowers a company more in the estimation of right thinking people generally ... than a public display of executive greed in an affluent world going hand in hand with a public display of corporate miserliness and indifference towards those at the bottom in an impoverished world who contribute so munificently to our corporate wealth," he further said.

He received support for his resolution from the Joseph Rowntree Trust, with just under a million shares, while the CIS, which had £25bn under management and is a significant shareholder in Tesco, was among those who abstained on the vote.

South African fruit picker who attended the meeting said "Our children still go hungry ... we don't want to beg and borrow to stay alive. We are asking Tesco to give us what we deserve. We just want to live a life of dignity."

The meeting, which ran for more than three hours, was also addressed by a Bangladeshi textile worker who told the company that workers there are not being paid "a living wage".

In the end, 8.75% of shareholders refused to back the company's remuneration policy while 17.71% refused to back Sir Terry's special US bonus.

Investor Relations (IR)

Investor Relations describes the department of a company devoted to handling inquiries from shareholders and investors, as well as others who might be interested in a company's stock or financial stability.

Investor Relations (IR) is a strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between a company, the financial community, and other constituencies, which ultimately contributes to a company's securities achieving fair valuation.

Typically, investor relation is a department or person reporting to the Chief Financial Officer. In some companies, investor relation is managed by the public relations or corporate communications departments, and can also be referred to as "financial public relations" or "financial communications".

Many larger publicly-traded companies now have dedicated IR officers (IROs), who oversee most aspects of shareholder meetings, press conferences, private meetings with investors, (known as “one-on-one” briefings), investor relations sections of company websites, and company annual reports. The investor relations function also often includes the transmission of information relating to intangible values such as the company’s policy on corporate governance or corporate social responsibility. Recently, the field has trended toward an increasingly popular movement for “interactive data”, and the management of company filings through streaming-data solutions such as XBRL or other forms of electronic disclosure have become prevalent topics of discussion amongst leading IROs worldwide.

The investor relations function must be aware of current and upcoming issues that an organization or issuer may face, particularly those that relate to fiduciary duty and organizational impact. In particular, it must be able to assess the various patterns of stock-trading that a public company may experience, often as the result of a public disclosure (or any research reports issued by financial analysts). The investor relations department must also work closely with the Company Secretary on legal and regulatory matters that affect shareholders.

IRO’s have access to the Chief Executive Officer (CEO) and Chairman or President of the corporation. This means that being able to understand and communicate the company’s financial strategy, they are also able to communicate the broader strategic direction of the corporation and ensure that the image of the corporation is maintained in a cohesive fashion.

Due to the potential impact of legal liability claims awarded by courts, and the consequential impact on the company’s share price, IR often has a role in crisis management of, for example, corporate downsizing, changes in management or internal structure, product liability issues and industrial disasters.

The most highly-regarded professional member organization for Investor Relations in the United States is the National Investor Relations Institute, or NIRI. In the United Kingdom, the recognized industry body is The Investor Relations Society, while in Canada, the professional association is called the Canadian Investor Relations Institute, or CIRI. Australia’s professional organization is known as the Australian Investor Relations Association (AIRA).

ICSI Recommendations to strengthen Corporate Governance Framework recommends Constitution of Investor Relations Cell should be made mandatory for Listed Companies. The Investor Relations Meet after declaration of financial results should be compulsorily webcast in case of companies having a market capitalization of Rs.1000 Crore or more

The Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 significantly increased the importance of investor relations in the financial markets. The act established new requirements for corporate compliance and regulatory governance, with an increased emphasis on accuracy in auditing and public disclosure. Notable provisions of the act which apply to investor relations include enhanced financial disclosures and accuracy of financial reports, real-time disclosures, off-balance-sheet transaction disclosures, pro-forma financial disclosures, management assessment of internal controls, and corporate responsibility for financial reports. More specifically, Sarbanes-Oxley sections 301, 302, 404, and 802 have been of particular interest to companies improving corporate compliance. Similar to Sarbanes-Oxley are Bill 198 in Canada, LSF in France, and J-SOX in Japan. The European MiFID (Markets in Financial Instruments Directive), although principally concerned with investor protection, also covers regulation and compliance for listed European companies.

If the latest collection of balance sheets is any indication, corporate India is increasingly paying attention to investor relations, courtesy IROs whose roles are being fine-tuned like never before. Companies are strengthening their investor relations departments, multi-tasking them and hiring more people for improved investor communication.

Reporting Standards

Companies these days need to disclose much more. The current legal requirements are prompting companies to refine their reporting standards too.

The job-profile of IROs is changing as a result. IROs provide definite inputs to boards of directors and become part of companies' disclosure committees.

Investor Confidence

The responsibilities of the IRO, include:

- building interest in the firm on the buy side,
- anticipate market reaction towards M&As and divestitures,
- and building investor confidence in the firm.

Companies frequently need to convey important messages to shareholders, some of them related to performance and strategy, point out investment circles. "Communications these days is not merely about meetings with stakeholders."

Dynamic Role

The companies are playing dynamic roles now a day. They have separate sections on their website for investors and shareholders providing exclusive information and clarifications to analysts, retail and institutional investors.

ITC Ltd in its balance sheet pointed out how investors can make use of its Web site, which has two "exclusive sections" titled Shareholder Value and Investor Relations. Clarifications provided to institutional investors and analysts, including presentations made to them, are also posted. Incidentally, ITC's in-house investor service centre is accredited with ISO 9001:2000 certification. The company itself is registered with the SEBI has a Category II share transfer agent

Accounting professionals also note that company managements are attaching considerable importance to IROs and will play a more dynamic role in times to come, assisting managements in understanding shareholder psyche.

Examples of corporates' concern for shareholders are shown all over. The Ashok Leyland balance sheet, for instance, discusses the feedback on results/findings of a 'Shareholders' Satisfaction Survey' which has elicited over 1,660 responses.

"A large number of respondents had expressed concern about the slow movement in the share price of the company, expectation of bonus shares and also a higher quantum of dividend," Ashok Leyland has stated, adding that the feedback has been shared with the company's registrar and transfer agent, Integrated Enterprises (India) Ltd.

ROLE OF INSTITUTIONAL INVESTORS IN CORPORATE GOVERNANCE

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. In India, there are broadly the following types of institutional investors:

Development oriented financial institutions such as IFCI, IDBI and state financial corporations Insurance Companies- LIC, GIC and other subsidiaries

Banks

All mutual funds and including UTI

Pension Funds

For instance, an ordinary person will have a pension from his employer. The employer gives that person's pension contributions to a fund. The fund will buy shares in a company, or some other financial product. Funds are useful because they will hold a broad portfolio of investments in many companies. This spreads risk, so if one company fails, it will be only a small part of the whole fund's investment.

Most of the reports on corporate governance have emphasized the role which the institutional investors play in corporate governance. The Cadbury Committee (1992) states:

“Because of their collective stake we look to the institutions in particular, with the backing of the Institutional Share Holder’s Committee to use their influence as owners to ensure that companies in which they have invested comply with the code”

A similar view was expressed in **Greenbury Report (1995)** as one of the main action point is:

“the investor institution should use their power and influence to ensure that the implementation of the best practices set out in the code”

Similarly **Hampel Report (1998)** stated that:

“it is clear that a discussion of the role of shareholders in corporate governance will mainly concern the institution”.

Indian Scenario

Kumar Mangalam Birla Committee on Corporate Governance observed that:

- (a) Institutional shareholders have acquired a large stake in equity share capital of listed companies. In some of the listed companies they are the major shareholders and *own shares largely on behalf of the retail shareholders*.
- (b) They have a special responsibility given the weightage of their votes and have a bigger role to play in corporate governance *as retail investors look upon them for positive use of their voting rights*.
- (c) The Institutional shareholders can effectively use their powers to influence the standard of Corporate Governance.

Expectation of their role and recommendations

The committee therefore recommends that institutional shareholders should reflect the following characteristics:

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

Given the size of their shareholdings the power of the institutional investors cannot be doubted. Hirschman, in his seminal work, identified the exercise of institutional power within an ‘exit and voice’ framework, arguing that ‘dissatisfaction [may be expressed] directly to management’, the voice option, or by selling the shareholding, the exit option. The latter choice is not viable for many institutional investors given the size of their holdings or a policy of holding a balanced portfolio.

The Combined Code (2008) had also stated the following principles of good governance for the Institutional Shareholders

(a) Dialogue with companies

Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives.

(b) Evaluation of governance disclosures

When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional investors should give due weight to all relevant factors drawn to their attention.

(c) Shareholder voting

Institutional shareholders have a responsibility to make considered use of their votes.

ICSI Recommendations to strengthen Corporate Governance Framework:

Recommendation 22: It suggests that Corporate Governance Framework should be mandatory for:

- for equity based mutual funds to disclose on 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
- an annual disclosure of their voting records on their website

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.

Institutional Investors – Global Trends***UK Stewardship Code (2012)***

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. By creating a sound basis of engagement, stronger link between governance and the investment process shall be attained.

Institutional shareholders are free to choose whether or not to engage but their choice should be based on their investment approach. Compliance of the principles in the Code by institutions and its disclosure should assist companies to understand the approach and expectations of their major shareholders. They should also assist investors who have mandated institutional fund managers to make a better informed choice, thereby improving the functioning of the market and facilitating the exercise of responsibility to end-investors.

The code follows the concept of “Comply or Explain”.

Principle 1: Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

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.

Principle 2: Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

- An institutional investor's duty is to act in the interests of all clients and/or beneficiaries when considering matters such as engagement and voting.

- 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 and maintain a policy for managing conflicts of interest.

Example of conflict of interest: When a fiduciary institution which is a subsidiary or an affiliate of an integrated financial group, holds an interest in the investee company, whilst the latter has a contractual relationship with another company of the group. For example, a mutual fund belonging to a financial conglomerate that includes a commercial bank, an investment bank, and an insurance company, may face conflicts of interests if the insurance company manages the provident fund of the portfolio company; or if the commercial bank is also a lender to the portfolio company, or if the investment bank is underwriting an issue of shares by the portfolio company. In such cases, its voting decision might be influenced by the interests of other companies within the group.

ICSI Recommendations to strengthen Corporate Governance Framework — 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.

Principle 3: Institutional investors should monitor their investee companies.

Monitoring should take place regularly and be checked periodically for effectiveness and 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.

The explanations given for departure from the UK Corporate Governance Code should be carefully considered and reasoned judgements made 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 and those willing to become an insider should indicate in its stewardship statement the willingness to do so, as well as 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 activities as a method of protecting and enhancing shareholder value.

Institutional investors should set out the circumstances when 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. Initial discussions should take place on a confidential basis. However, if boards do not respond constructively when institutional investors intervene, then institutional investors will 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, senior independent director, or with all independent directors;
- intervening jointly with other institutions on particular issues;
- making a public statement in advance of the AGM or an EGM;
- submitting resolutions at shareholders’ meetings; and
- requisitioning an EGM, in some cases proposing to change board membership.

Principle 5: Institutional investors should be willing to act collectively with other investors where appropriate.

- Collaborative engagement may be most appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten the ability of the company to continue.
- Institutional investors should disclose their policy on collective engagement.
- When participating in collective engagement, institutional investors should have due regard to their policies on conflicts of interest and insider information.

Principle 6: Institutional investors should have a clear policy on voting and disclosure of voting activity.

- 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 and if they do not explain why.

Principle 7: Institutional investors should report periodically on their stewardship and voting activities.

Transparency is an important feature of effective stewardship. Confidentiality in specific situations may well be crucial to achieving a positive outcome. Institutional investors should regularly report to their clients details of how they have discharged their responsibilities. Companies should consider obtaining an independent audit opinion on their engagement and voting processes having regard to the accepted international standards. The existence of such assurance certification should be publicly disclosed.

PRI- Principles for Responsible Investment- An investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact

The United Nations-backed Principles for Responsible Investment Initiative (PRI) is a network of international investors working together to put the six Principles for Responsible Investment into practice.

The Principles were devised by the investment community. They reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios and therefore must be given appropriate consideration by investors if they are to fulfil their fiduciary (or equivalent) duty. The Principles provide a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices and so better align their objectives with those of society at large.

Institutional investors have a duty to act in the best long-term interests of the beneficiaries. In this fiduciary role, 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). Applying these Principles may better align investors with broader objectives of society. Thereby, institutional investors commit to the following:

1. Incorporation of 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 and 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
- Advocate ESG training for investment professionals

2. Perform as active owners and incorporate ESG issues into their ownership policies and practices.

Possible actions:

- Develop and disclose an active ownership policy consistent with the Principles
- Exercise voting rights or monitor compliance with voting policy (if outsourced)
- Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights)
- File shareholder resolutions consistent with long-term ESG considerations
- Engage with companies on ESG issues
- Participate in collaborative engagement initiatives
- Ask investment managers to undertake and report on ESG-related engagement

3. Seek appropriate disclosure on ESG issues by the entities in which investment has been made.

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

4. Promote the acceptance and implementation of the Principles within the investment industry.

Possible actions:

- 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

- Support the development of tools for benchmarking ESG integration

5. Work together to enhance effectiveness in implementing the Principles.

Possible actions:

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning
- Collectively address relevant emerging issues
- Develop or support appropriate collaborative initiatives

6. Report on 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 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.

There are five key principles:

An institutional investor should incorporate sustainability considerations, including environmental, social and governance, 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 demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities.
2. 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.
3. An institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should proactively manage these when they occur.
4. Institutional investors should be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments.

California Public Employees’ Retirement System

California Public Employees’ Retirement System (CalPERS) manages retirement benefits for more than 1.6 million California public employees, retirees, and their families. The corporate governance team at CalPERS challenges companies and the status quo; vote proxies; work closely with regulatory agencies to strengthen financial markets; and *invest with partners that use corporate governance strategies to add value to the*

fund by turning around ailing companies. As a strategy CalPERS invest in sick and ailing companies where it employs good governance practices to improve company's overall performance.

“Corporate Governance,” at CalPERS, means the “relationship among various participants in determining the direction and performance of corporations. The primary participants are (1) shareowners, (2) management (led by the chief executive officer), and (3) the board of directors.” (Robert Monks and Nell Minow, *Corporate Governance 1* (1995))

CalPERS corporate engagement process has the overarching objective of improving alignment of interest between providers of capital and company management. It is CalPERS view that improved alignment of interest will enable the fund to fulfill its fiduciary duty to achieve sustainable risk adjusted returns.

There are three main drivers in the corporate engagement program:

- **Financial Performance** – company engagement to address persistent, relative value destruction, through the Focus List Program
- **Value Related Risk** – material environmental, social and governance factors, such as reputational risk, climate change, board diversity and key accountability measures such as majority voting
- **Compliance** – in response to State or Federal legislation.

CalPERS also have company specific engagement, which can be viewed as a strategy for addressing related risks. Compliance is a requirement and mitigates both financial reputational risks for CalPERS

CalPERS issued **Global Principles of Accountable Corporate Governance** which were updated on 16th February, 2010. The underlying tenet for CalPERS' Core Principles of Accountable Corporate Governance is that fully accountable corporate governance structures produce, over the long term, the best returns to share owners. CalPERS' Global Principles are broken down into four areas – Core, Domestic, International, and Emerging Markets Principles.

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:

(i) 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.

(ii) 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.

(iii) 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.

(iv) 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.

CORE PRINCIPLES OF ACCOUNTABLE CORPORATE GOVERNANCE

- 1. Optimizing Share owner Return:** Corporate governance practices should focus the board's attention on optimizing the company's operating performance, profitability and returns to share owners.
- 2. Accountability:** Directors should be accountable to share owners and management accountable to directors. To ensure this accountability, directors must be accessible to share owner 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 share owners with the information necessary to make informed voting decisions. Similarly, proxy materials should be distributed in a manner designed to encourage share owner participation. All share owner 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 share owners 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 share owner value. In turn, despite differing investment strategies and tactics, share owners should encourage corporate management to resist short-term behavior by supporting and rewarding long-term superior returns.

8. Access to Director Nominations: Share owners should have effective access to the director nomination process.

FEW EXAMPLES

SATYAM FIASCO

On 16th December, Satyam Computer Services Limited (now Tech Mahindra) announced its audacious plan to acquire controlling interest in Maytas Infrastructure and Maytas Properties for US\$1.6 billion. The family of Ramalinga Raju had a large shareholding in these two Maytas companies. The deal was cleared by Satyam's board of directors which had several reputed independent directors. The move was aimed at transferring over 60 billion of cash from Satyam's shareholders to the Raju family which defacto controlled Satyam (with only 8% shareholding) and Maytas companies (with a substantial shareholding).

This **outraged the mutual funds and institutional investors** in India, who threatened legal action. The deal was announced by Satyam after the Indian markets had closed on December 16, 2008, but Satyam's ADR crashed over 50% when it opened for trading in the US. In view of the outrage, the deal was cancelled next day. The share price still crashed 30% and continued to fall even after the deal was cancelled. This forced the Chairman of the company to confess the fraud on January 7, 2009. He admitted in a letter to the stock exchanges and SEBI, that he had falsified the books of Satyam. He and his brother and the MD and the CFO of Satyam resigned.

SHAREHOLDERS vs. MARKS & SPENCER

Shareholders in UK high-street name Marks & Spencer had been calling for the company to split the role of chairman and chief executive since Sir Stuart Rose assumed both roles in March 2008. In the AGM 2009 held 40% of shareholders backed a special motion put forward by the **Local Authority Pension Fund Forum (LAPFF)** calling for the retailer to appoint a new chairman to replace Sir Stuart Rose by July 2010, a year earlier than planned. The motion required 75% backing to be passed which it failed to attain. The LAPFF was protesting about Sir Stuart's joint role as chief executive and chairman

In November 2009 however, their calls were answered when Marc Bolland was appointed as chief executive. Bolland kicked off his tenure with a Golden Hello of £15m.

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.

LESSON 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.

Lesson 8

Corporate Governance and Other Stakeholders

LESSON OUTLINE

- Stakeholder Concept
- Recognition of Stakeholder Concept In Law
- Stakeholder Engagement
- Stakeholder Analysis
- Types of Stakeholders
- Caux Round Table
- Clarkson Principle of Stakeholder Management
- Governance Paradigm and Stakeholders
- Conclusion
- Lesson Round-Up
- Self Test Questions

LEARNING OBJECTIVES

The objective of the study lesson is to enable the students to understand the 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.

“Companies, to date, have often used the excuse that they are only beholden to their shareholders, but we need shareholders to think of themselves as stakeholders in the well being of society as well.”

– Simon Mainwaring

INTRODUCTION: STAKEHOLDER CONCEPT

Students may have heard the word “stakeholders” mentioned in the media from time to time. In a business context, customers, investors and 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. These groups are influenced by business, but they also have the ability to affect businesses.

Stakeholders provide resources that are more or less critical to a firm’s long-term success. These resources may be both tangible and intangible. Shareholders, for example, supply capital; suppliers offer material resources or intangible knowledge; employees and managers grant expertise, leadership, and commitment; customers generate revenue and provide infrastructure; and the society builds its positive corporate images.

The primary purpose of corporate leadership is to create wealth legally and ethically. This translates to bringing a high level of satisfaction to five constituencies - customers, employees, investors, vendors and the society-at-large. The *raison d’être* of every corporate body is to ensure predictability, sustainability and profitability of revenues year after year.

–*N.R. Narayana Murthy, Executive Chairman of the Board*

The classic definition of a stakeholder is ‘any group or individual who can affect or is affected by the achievement of the organization’s objectives’ (Freeman1984:46).

The concept was elaborated by Evans & freeman as the following two principles:

1. Principles of corporate legitimacy:

The corporation should be managed for the benefit of its stakeholders: its customers, suppliers, owners, employees & local communities. The rights of these groups must participate, in some sense, in decisions that substantially affect their welfare.

2. The stakeholder fiduciary principle:

Management bears a fiduciary relationship to stakeholders and to the corporation as an abstract entity. It must act in the interest of the stakeholders as their agent, and it must act in the interests of the corporation to ensure the survival of the firm, safeguarding the long-term stakes of each group.

Another definition of Stakeholder given subsequently by Freeman: “Those groups who are vital to the survival & success of the corporation” and the two principles were altered and renamed:

1. The stakeholder enabling principle:

Corporations shall be managed in the interest of stakeholders.

2. The principle of director responsibility:

Directors of a corporation shall have a duty of care to use reasonable judgment to define and direct the affairs of the corporation in accordance with the stakeholder enabling principle.

RECOGNITION OF STAKEHOLDER CONCEPT IN LAW

The stakeholder concept has been reflected in the laws governing the corporates for a long period. The labour laws seeks to ensure fair and equitable treatment to employees, the environment protection laws seeks ensure adoption of measures which will minimize the negative impact on environment. Tax laws give incentives in the form of tax holidays for development of backward areas. Tax benefits in the form of exemptions for donations made to recognized funds and organizations etc.

But an interesting development of recent origin is the definition of director's duties in the company laws of various jurisdictions which highlight care for stakeholders as a duty of directors.

A case to highlight this is the duties of directors set out in the UK Companies Act of 2006:

172. Duty to promote the success of the company

(1) A director of a company must act in a manner 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.

Companies Act, 2013 - Section 166(2)

"A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interest of the company, its employees, the community and the environment."

Listing Agreement - Clause 49 (I) (B)

The Listing agreement provides that the company should recognize the rights of stakeholders and encourage co-operation between company and the stakeholders.

- (a) The rights of stakeholders that are established by law or through mutual agreements are to be respected.
- (b) Stakeholders should have the opportunity to obtain effective redress for violation of their rights.
- (c) Company should encourage mechanisms for employee participation.
- (d) 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.
- (e) The company 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 an alliance-building tool. Corporations practice stakeholder engagement in an effort to understand the needs of their stake-holders, 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.

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.

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.

BETTER STAKEHOLDERS 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; and

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

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 based on the belief that the world business community should play an important role in improving economic and social conditions. As a statement of its aspirations, it developed a document that aims to express a world standard against which business behavior can be measured.

The Caux Round Table was founded in 1986 by Frederick Phillips, former President of Philips Electronics and Olivier Giscard d'Estaing, former Vice-Chairman of INSEAD, as a means of reducing escalating trade tensions.

The CRT Principles for Business were formally launched in 1994, and presented at the United Nations World Summit on Social Development in 1995. The CRT Principles for Business articulate a comprehensive set of ethical norms for businesses operating internationally or across multiple cultures. The CRT Principles for Business emerged from a series of dialogues catalyzed by the Caux Round Table during the late 1980's and early 1990's. The Principles are comprehensive statement of responsible business practice formulated by business leaders for business leaders.

These principles are rooted in two basic ethical ideals: *kyosei* and human dignity. 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" 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.

Business behavior can affect relationships among nations and the prosperity and wellbeing of us all. Business is often the first contact between nations and, by the way in which it causes social and economic changes, has a significant impact on the level of fear or confidence felt by people worldwide. The emphasis is on seeking to establish what is right rather than who is right.

Section 1. Preamble

The mobility of employment, capital, products and technology is making business increasingly global in its transactions and its effects.

Law and market forces are necessary but insufficient guides for conduct.

Responsibility for the policies and actions of business and respect for the dignity and interests of its stakeholders are fundamental.

Shared values, including a commitment to shared prosperity, are as important for a global community as for communities of smaller scale.

For these reasons, and because business can be a powerful agent of positive social change, we offer the following principles as a foundation for dialogue and action by business leaders in search of business responsibility. In so doing, we affirm the necessity for moral values in business decision making. Without them, stable business relationships and a sustainable world community are impossible.

Section 2. General Principle

Principle 1. The Responsibilities of Businesses:

Beyond Shareholders toward Stakeholders

The value of a business to society is the wealth and employment it creates and the marketable products and services it provides to consumers at a reasonable price commensurate with quality. To create such value, a business must maintain its own economic health and viability, but survival is not a sufficient goal.

Businesses have a role to play in improving the lives of all their customers, employees, and shareholders by sharing with them the wealth they have created. Suppliers and competitors as well should expect businesses to honor their obligations in a spirit of honesty and fairness. As responsible citizens of the local, national, regional and global communities in which they operate, businesses share a part in shaping the future of those communities.

Principle 2. The Economic and Social Impact of Business:

Toward Innovation, Justice and World Community

Businesses established in foreign countries to develop, produce or sell should also contribute to the social advancement of those countries by creating productive employment and helping to raise the purchasing power of their citizens. Businesses also should contribute to human rights, education, welfare, and vitalization of the countries in which they operate.

Businesses should contribute to economic and social development not only in the countries in which they operate, but also in the world community at large, through effective and prudent use of resources, free and fair competition, and emphasis upon innovation in technology, production methods, marketing and communications.

Principle 3. Business Behavior:

Beyond the Letter of Law Toward a Spirit of Trust

While accepting the legitimacy of trade secrets, businesses should recognize that sincerity, candor, truthfulness, the keeping of promises, and transparency contribute not only to their own credibility and stability but also to the smoothness and efficiency of business transactions, particularly on the international level.

Principle 4. Respect for Rules

To avoid trade frictions and to promote freer trade, equal conditions for competition, and fair and equitable treatment for all participants, businesses should respect international and domestic rules. In addition, they should recognize that some behavior, although legal, may still have adverse consequences.

Principle 5. Support for Multilateral Trade

Businesses should support the multilateral trade systems of the GATT/World Trade Organization and similar international agreements. They should cooperate in efforts to promote the progressive and judicious liberalization of trade and to relax those domestic measures that unreasonably hinder global commerce, while giving due respect to national policy objectives.

Principle 6. Respect for the Environment

A business should protect and, where possible, improve the environment, promote sustainable development, and prevent the wasteful use of natural resources.

Principle 7. Avoidance of Illicit Operations

A business should not participate in or condone bribery, money laundering, or other corrupt practices: indeed, it should seek cooperation with others to eliminate them. It should not trade in arms or other materials used for terrorist activities, drug traffic or other organized crime.

Section 3. Stakeholder Principles**Customers**

All customers should be treated with dignity, irrespective of whether they purchase our products and services directly from us or otherwise acquire them in the market. Therefore there is a responsibility to:

- provide customers with the highest quality products and services consistent with their requirements;
- treat customers fairly in all aspects of our business transactions, including a
- high level of service and remedies for their dissatisfaction;
- make every effort to ensure that the health and safety of customers, as well as the quality of their environment, will be sustained or enhanced by the products and services;
- assure respect for human dignity in products offered, marketing and advertising;
- and respect the integrity of the culture of customers.

Employees

Dignity of every employee and in taking employee interests seriously. Therefore there is a responsibility to:

- provide jobs and compensation that improve workers' living conditions;
- provide working conditions that respect each employee's health and dignity;
- be honest in communications with employees and open in sharing information,
- limited only by legal and competitive constraints;
- listen to and, where possible, act on employee suggestions, ideas, requests and complaints;
- engage in good faith negotiations when conflict arises;
- avoid discriminatory practices and guarantee equal treatment and opportunity in areas such as gender, age, race, and religion;
- promote in the business itself the employment of differently-abled people in places of work where they can be genuinely useful;
- protect employees from avoidable injury and illness in the workplace;
- encourage and assist employees in developing relevant and transferable skills and knowledge; and

- be sensitive to the serious unemployment problems frequently associated with business decisions, and work with governments, employee groups, other agencies and each other in addressing these dislocations.

Owners/Investors

Honoring the trust of investors. Therefore there is a responsibility to:

- apply professional and diligent management in order to secure a fair and competitive return on the owners' investment;
- disclose relevant information to owners/investors subject to legal requirements and competitive constraints;
- conserve, protect, and increase the owners/investors' assets; and
- respect owners/investors' requests, suggestions, complaints, and formal resolutions.

Suppliers

The relationship with suppliers and subcontractors must be based on mutual respect. Therefore there is a responsibility to :

- seek fairness and truthfulness in all activities, including pricing, licensing, and rights to sell;
- ensure that business activities are free from coercion and unnecessary litigation;
- foster long-term stability in the supplier relationship in return for value, quality, competitiveness and reliability;
- share information with suppliers and integrate them into planning processes;
- pay suppliers on time and in accordance with agreed terms of trade; and
- seek, encourage and prefer suppliers and subcontractors whose employment practices respect human dignity.

Competitors

Fair economic competition is one of the basic requirements for increasing the wealth of nations and ultimately for making possible the just distribution of goods and services. Therefore there is a responsibility to:

- foster open markets for trade and investment;
- promote competitive behavior that is socially and environmentally beneficial and demonstrates mutual respect among competitors;
- refrain from either seeking or participating in questionable payments or favors to secure competitive advantages;
- respect both tangible and intellectual property rights; and
- refuse to acquire commercial information by dishonest or unethical means, such as industrial espionage.

Communities

As global corporate citizens companies can contribute to such forces of reform and human rights as are at work in the communities in which corporates operate. Therefore they have a responsibility in those communities to:

- respect human rights and democratic institutions, and promote them wherever practicable;
- recognize government's legitimate obligation to the society at large and support public policies and practices that promote human development through harmonious relations between business and other segments of society;

- collaborate with those forces in the community dedicated to raising standards of health, education, workplace safety and economic well-being;
- promote and stimulate sustainable development and play a leading role in preserving and enhancing the physical environment and conserving the earth's resources;
- support peace, security, diversity and social integration;
- respect the integrity of local cultures; and
- be a good corporate citizen through charitable donations, educational and cultural contributions, and employee participation in community and civic affairs.

THE CLARKSON PRINCIPLE OF STAKEHOLDER MANAGEMENT

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. The Clarkson Principles emerged from a project undertaken by the Centre for Corporate Social Performance and Ethics :

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 all stakeholders, and should address such conflicts through open communication, appropriate reporting and incentive systems and, where necessary, third party review.

Companies are often times at crossroads to balance the interests of different stakeholders so that no particular stakeholder is either at an additional advantage or at disadvantage over the others. Corporate Boards and leadership must display an outstanding understanding of practical business ethics. They need not only do but also appear to do justice to diverse pulls and pressures from a complex array of stakeholders.

Governance Paradigm and Stakeholders

EMPLOYEES

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

Employees have a stake in the long-term success of the corporation. In that regard the shareholders are not the only residual claimants. “Employees possess skills and knowledge which are specific to their particular corporation and may be of limited value if they were to become employed elsewhere. Moreover, employees care about a wide range of decisions within corporations.” - Greenfield (1998)

On September 30, 2003, the U.S. District Court in Houston issued the first substantive decision in the Enron ERISA (The Employee Retirement Income Security Act of 1974) litigation (*Tittle v Enron Corp.*). The class action lawsuit included all 20,000 former Enron workers who were participants in or beneficiaries of Enron Corporation Savings Plan, (401(k) Plan) from January 20, 1998, through December 2, 2001, and who made or maintained investments in Enron stock. It also included participants of the Enron Stock Ownership Plan or Cash Balance Plan.

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.

Inception of Whistle Blower Policy – A Good Governance Initiative

The concept of Whistle Blower Policy has been established in India through non-mandatory requirement of Clause 49 of Listing agreement. Further, Corporate Governance Voluntary Guidelines, 2009 issued by the Ministry of Corporate Affairs provide for the instituting mechanism for Whistle Blowing. These provides that-

- the Company should ensure the institution of a mechanism for employees to report concern 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.

Further the Department of Public Enterprises (DPE) ‘Guidelines on Corporate Governance for CPSEs 2010’ also provide for establishment of a mechanism for whistle blower policy and state that once established, the existence of the mechanism may be appropriately communicated within the organization.

RECENT DEVELOPMENTS

1. Companies Act, 2013

The Companies Act, 2013 mandated to establish vigil mechanism which will enable a company to evolve a process to encourage ethical corporate behaviour, while rewarding employees for their integrity and for providing valuable information to the management on deviant practices.

According to Section 177(9) of the Companies Act, 2013 read with rule 7 of Companies (Meetings of Board and its Powers) Rules, 2014, establishment of vigil mechanism is mandatory for all listed companies and Companies that accept deposits from public or companies that have borrowed money from banks and public financial institutions in excess of Rs 50 crore.

The companies which are required to constitute an audit committee shall oversee the vigil mechanism through the committee and 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.

The vigilance mechanism has to be backed with adequate safeguards against victimization of whistleblowers and should provide direct access to the Chairperson of the Audit Committee or the director nominated to play the role of Audit Committee in exceptional cases.

In addition, Independent directors and the audit committee are mandated to ensure that the vigil mechanism is “adequate” and “functional”. The duty is also cast on the Auditors to report fraud by employees of the company to the central government within a prescribed time.

2. Revised Clause 49 of Listing Agreement

As per the revised clause 49 of Listing Agreement issued by the Securities and Exchange Board of India, w.e.f. 1st October, 2014 it would be mandatory for every listed company to have a vigil mechanism for directors and employees to report concerns on unethical behavior, actual or suspected fraud or violation of the company's code of conduct or ethics policy, to management.

Further, the company is required to provide safeguards against victimisation of whistleblowers and direct access to the chairman of audit committee in exceptional cases. The details of whistle blower policy/vigil mechanism should be disclosed by the company on its website and in the Board's Report as well.

3. The Whistle Blower Protection Act, 2011

Corruption is a social evil and one of the impediments felt in eliminating corruption in the Government and the public sector undertakings is lack of adequate protection to the complainants reporting the corruption or wilful misuse of power or wilful misuse of discretion which causes demonstrable loss to the Government or commission of a criminal offence by a public servant.

The Whistle Blowers Protection Bill was introduced on August 26, 2010. It was referred to a Parliamentary Standing Committee on September 16, 2010, which had given its report on June 9, 2011. The Bill was passed by the Lok Sabha and Rajya Sabha on December 27, 2011 and February 21, 2014 respectively.

Finally, Whistle Blowers Protection Act, 2011 got the assent of the President of India on 9th May 2014 and a notification in the Official Gazette of India was issued on 12th May, 2014 to make it a complete legislation to provides a system to encourage people to disclose information about corruption or the wilful misuse of power by public servants, including ministers. The law provides safeguards against victimization of the person who makes the complaint. The Act is expected to become effective in course of this year.

Enron employees sued the trustee, the administrative committee, various corporate officers, and the outside directors of Enron, alleging that they had breached their fiduciary duties under ERISA by failing to disclose the company's true financial condition and by continuing to invest plan assets in Enron stock. The court decision allowed most of the fiduciary claims to proceed.

When employees own corporate stock through their retirement plan or a separate employee stock ownership plan (ESOP), their right to participate in decision-making takes on a new dimension. Indeed, employees have an ethical right to participate based on their years of service and retirement investments, both of which are at risk.

The German corporate governance is shaped by a legal tradition that dates back to the 1920s and regards corporations as entities which act not only in the interests of their shareholders, but also serve other stakeholder interests. The German concept of corporate governance reflects the legal rights and arrangements that underlie how decision-making rights are distributed in a company.

Companies can take initiative to improve its engagement with the stakeholders particularly other than the shareholders and investors. Some companies in India took good initiative for their stakeholders. One of them is HCL employee first approach which we are discussing here:

The Employees-First Effect

In 2005, HCL had begun a series of experiments based upon a radical new management philosophy, “Employees First, Customers Second,” (EFCS) which in many ways turned the traditional management hierarchy upside down. The aim of EFCS was to create trust grow through transparency, to make managers as accountable to employees as employees were to their bosses, to transfer the responsibility for change and value creation to front-line employees working in the “value zone,” where HCL and its customers interact. Systems and processes were put in place designed to achieve these goals.

As a business philosophy, EFCS attracted the attention of academics (Harvard Business School did a case study on the approach), the media (Fortune magazine characterized HCL management as “the world’s most modern”), and analysts (a Gartner research report highlighted the customer benefits of Employees First).

Empowered employees at HCL are now running the next era of growth at HCL, leading implementation of EFCS 2.0. In the first phase EFCS was management-driven, employee-embraced; EFCS today is more employee-driven, management-embraced. EFCS 2.0 is all about embracing a new, radical order, one where employees pick up the baton and take the lead.

Key programs that drive EFCS 2.0:

- **Meme:** An online social networking platform created by employees. Unlike the official company intranet, you might call Meme social@workplace. It has nearly 60,000 members.
- **MAD JAM:** A bottom-up initiative designed by frontline employees, for frontline employees, the “Make-a-Difference Jamboree” recognizes and celebrates employee-led innovations for customers.
- **MAD LTD:** A program focused on nurturing young leaders by showcasing and helping to implement their ideas improved society – to “Make a Difference, Lead the Difference.”
- **Power of One:** A social responsibility initiative, “Power of One” has HCL-ites spending a day with the community and experiencing the power of giving. The program transforms individual efforts into an avalanche of positive social activism.
- **ArKMedes:** A platform focused on making knowledge a uniform currency across the organization by bringing together communities driven by passionate employees.

CUSTOMERS

Customer satisfaction is one of the most important aspects of firm performance. Most of organizations seek higher revenue, revenue as per the business dictionary is defined as: the income that a company receives from its normal business activities, usually from the sale of goods and services to customers.

In today’s global environment, customers have innumerable choices. Therefore, corporates need to establish a differentiation. The differentiation is established in terms of quality and price of the product or service. Customers

are also driving corporates to consider environmental factors in designing the products and services. Crane and Matten (2004) state that there is “much evidence to suggest that many consumers do indeed include ethical considerations in their evaluations of businesses and the products they sell” (p.290).

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.

LENDERS

Lenders are the one providing financial stability to the organisation by way of loans, overdraft facility etc. It includes banks/lending institutions which should take into account the corporate governance practices and financial strengths of the organisation before sanctioning any finance, as they are providing their customer money to the organization seeking financial assistance.

Lenders like shareholders provide the capital for a company. The traditional view of corporate governance, however, is that shareholders mainly influence the decisions that managers make through the company’s board of directors. In “Creditor Control Rights, Corporate Governance, and Firm Value” the authors find that creditors exert substantial control over a company when its performance starts to deteriorate, but well before it goes bankrupt.

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. As at 4 June 2013, 79 adopting financial institutions in 35 countries have officially adopted the Equator Principles, covering over 70 percent of international Project Finance debt in emerging markets.

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.

The Microsoft Preferred Supplier Program: *Exceptional Suppliers, Exceptional Value*

The Microsoft Preferred Supplier Program (MPSP) makes it easy for Microsoft employees to work globally with a prequalified, select group of suppliers. The objective is to make working with Microsoft beneficial to all. The program is currently available in Australia, Brazil, Canada, China, France, Germany, Japan, United Kingdom and United States. In the future, the program will be available in other countries and regions worldwide.

The goal of MPSP is simple: To enable new efficiencies for both Microsoft and suppliers, bringing new value to the relationship that they are building together.

Program Highlights

A primary purpose of MPSP is to define the way suppliers do business with Microsoft, including requirements and expectations, to create a clear, straight path to success. The following are some key elements of MPSP:

- MPSP includes suppliers of all kinds of goods and services.
- The program includes only suppliers who are the best in providing their category.
- MPSP suppliers are divided into two distinct levels—premier supplier and preferred supplier—to provide a hierarchy of benefits and visibility to MPSP suppliers.
- MPSP is committed to diversity, including exceeding government-mandated goals and requiring MPSP suppliers to share in this goal

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.

In India, Ministry of Corporate Affairs (MCA) prescribed the following voluntary measures in the context of Corporate Governance:

CORPORATE GOVERNANCE VOLUNTARY GUIDELINES 2009

The Ministry of Corporate Affairs has been working towards strengthening of the corporate governance framework through a two pronged strategy. Some aspects which needed to be incorporated in the law have been included in the proposed Companies Bill, 2012. However, keeping in view the objective of encouraging the use of better practices through voluntary adoption, the Ministry has issued a set of Corporate Governance Voluntary Guidelines in 2009 which not only serve as a benchmark for the corporate sector but also help them in achieving the highest standard of corporate governance.

CORPORATE SOCIAL RESPONSIBILITY (CSR) VOLUNTARY GUIDELINES, 2009

The Indian business has traditionally been socially responsible. From inactive philanthropy to the incorporation of the stakeholders' interest in the business model, the Indian business sector practices various methods of discharging its social responsibility. While a lot of human and economic energy is available for utilization in this area, a suitable mechanism is required to channelize this energy for which the Government, corporate sector and the communities need to partner together. Against this background, the Ministry of Corporate Affairs has decided to bring out CSR voluntary guidelines for responsible business which will add value to the operations and contribute towards the long term sustainability of the business. These guidelines will also enable business to focus as well as contribute towards the interests of the stakeholders and the society.

NATIONAL VOLUNTARY GUIDELINES ON SOCIAL, ENVIRONMENTAL & ECONOMIC RESPONSIBILITIES OF BUSINESS

The Ministry of Corporate Affairs had released Voluntary Guidelines on CSR in 2009 as the first step towards mainstreaming the concept of Business Responsibilities. Keeping in view the feedback from stakeholders, it was decided to revise the same with a more comprehensive set of guidelines that encompasses social, environmental and economical responsibilities of business. Accordingly, MCA issued a new set of National Voluntary Guidelines on Social, Environmental & Economic Responsibilities of Business in July 2011.

The Guidelines emphasize that businesses have to endeavour to become responsible actors in society, so that their every action leads to sustainable growth and economic development. Accordingly, the Guidelines use the terms 'Responsible Business' instead of Corporate Social Responsibility (CSR) as the term 'Responsible Business' encompasses the limited scope and understanding of the term CSR.

The Guidelines have been articulated in the form of nine (9) Principles with the Core Elements. A suggested approach for adopting these guidelines, the steps for building a strategy for responsible business as well as business responsibility reporting framework, have been prescribed under the Guidelines.

SEBI - BUSINESS RESPONSIBILITY REPORT

Securities Exchange Board of India (SEBI) vide circular CIR/CFD/DIL/8/2012 dated August 13, 2012 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. This is more relevant for listed entities which, considering the fact that they have accessed funds from the public, have an element of public interest involved, and are obligated to make exhaustive continuous disclosures on a regular basis.

As per the circular the requirement to include BR Reports as part of the Annual Reports shall be mandatory for top 100 listed entities based on market capitalisation at BSE and NSE as on March 31, 2012. ***Other listed entities may voluntarily disclose BR Reports as part of their Annual Reports.***

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 from 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.

Governance Norms for Stakeholders under Companies Act, 2013

The Stakeholders Relationship Committee

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.

Penalty for Contravention

The company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees. Every officer of the company who is in default shall be punishable with

imprisonment for a term which may extend to one year or with fine not less than rupees twenty five thousand but which may extend to one lakh rupees or with both.

The non-consideration of resolution of any grievance by the Stakeholders Relationship Committee in good faith shall not constitute a contravention of this section.

Schedule IV under Section 149(7) of the Act contains the Code for Independent Directors. Under Sl. No. II (5) of the Code, Independent Directors are mandated to safeguard the interest of all stakeholders, especially the Minority Shareholders and balance the conflicting interests of the stakeholders.

The requirement for a Stakeholders Relationship Committee is an interesting one. Relationships with stakeholders can be critical, and balancing the contending interests of different stakeholder groups and building mutually beneficial relationships with stakeholders are hallmarks of the effective board.

Governance Norms for Stakeholders under Listing Agreement

Clause 49(VIII)(E)(4) of Listing Agreement provides 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.

CONCLUSION

Building a company with recognized values has become a point of competitive advantage. Doing the right thing attracts all the positive energies, it builds trust, the most important business asset. To be globally competitive and acceptable, companies have to ensure that they establish a business reputation.

Corporations are expected to "build a better future" – not only for their shareholders but also for their customers, workers, business partners, community, nation and the wider world. Those with effective corporate governance

based on this core value will have an added competitive advantage: attracting and retaining talent and generating positive reactions in the marketplace.

The tone at the top translates and permeates into every relationship of a corporation, whether it be with investors, employees, customers, suppliers, regulators, local communities or other constituents. One of the most important factors in ensuring that a board functions effectively is getting the right “tone at the top” of the corporation. Setting corporate culture, and the values by which executives throughout a group will behave, should be one of a board’s highest priorities.

LESSON ROUND UP

- Stakeholders provide resources that are more or less critical to a firm’s long-term success. These resources may be both tangible and intangible. Shareholders, for example, supply capital; suppliers offer material resources or intangible knowledge; employees and managers grant expertise, leadership, and commitment; customers generate revenue and provide infrastructure; and the society builds its positive corporate images.
- 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 interest of the company, its employees, the community and the environment.
- Stakeholder engagement leads to increased transparency, responsive-ness, compliance, organizational learning, quality management, accountability and sustainability. Stakeholder engagement is a central feature of sustainability performance.
- 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.
- Customers are considered as the king to drive the market and they can sometimes exercise influence by consolidating their bargaining power in order to get lower prices.
- The lenders put a check and balance on the governance practices of an organisation to ensure safety of their fund and as a societal responsibility.
- The organisation which builds a mutually strong relationship with its vendors improves its overall performance in the marketplace.
- 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 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.
- Whistle Blower Protection is an essential pillar in Corporate Governance framework of a company and it is the responsibility of governance professionals serving as director, consultant, auditors and employees to ensure that the companies to which they are associated should adopt and implement vigil mechanism/ whistle blower policy. The benefits derived from this mechanism would protect the company from any reputational crisis.

Lesson 9

Risk Management and Internal Control

LESSON OUTLINE

- Introduction
- Risk Management
- Risk Classification
- Risk Management Process
- Advantages of Risk Management
- Fraud Risk Management
- Reputation Risk Management
- Non-Compliance Risk Management
- Responsibility of Risk Management
- Role of Company Secretary in Risk Management
- Internal Control System
- COSO's Internal Control Framework
- Role and Responsibilities in Internal Control
- Lesson Round-Up
- Self-Test Questions

LEARNING OBJECTIVES

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.

This study further elaborates on the Internal Control Systems, including COSO and Roles and Responsibilities with regard to Internal Control.

“A prudent man foresees the difficulties ahead and prepares for them; the simpleton goes blindly on and suffers the consequences.”

– Proverbs 22:3

INTRODUCTION

In this dynamic world, corporate governance demands that boards respond to new challenges, by putting in place measures which will systematically and thoroughly identify, analyse and control risks. World over, the need for putting in place better systems of internal controls and a cohesive risk management framework is being stressed. Legislations like the Sarbanes-Oxley Act in the United States, the Turnbull Commission in UK, the listing rules and agreements in different countries require that the directors should be directly responsible in ensuring that the company has in place effective and efficient systems and risk management frameworks. In this study lesson we will look at the aspects of Risk Management and Internal Control Systems.

SEGMENT I - RISK MANAGEMENT

Any organization, public or private, large or small, faces internal and external uncertainties that affect its ability to achieve its objectives. The effect of uncertainty on an organization's objectives is "risk." Risk management, commonly known in the business community as enterprise risk management (ERM), can provide for the structured and explicit consideration of all forms of uncertainty in making any decision. The overarching principle of ERM is that it must produce value for the organization. It is the culture, processes and structures that is directed towards taking advantage of potential opportunities while managing potential adverse effects.

Corporations face the task of managing their risk exposures while remaining profitable and competitive at the same time. Managing risks is not a new challenge, yet it may get overlooked due to several reasons. The challenges and demands of contemporary markets, customer expectations, regulatory authorities, employees and shareholders present organizations with an interesting array of contradictions.

Risk management can enhance the environment for identifying and capitalizing on opportunities to create value and protect established value. Efficient managers who undertake risk, use a variety of risk management solutions that transcends through traditional insurance risk transfer products.

The rapidly changing global economy has created an expanding array of risks to be managed to ensure the viability and success of an enterprise. Historically, the practice of risk management has been confined to the traditionally insurable risks such as loss from fire, earthquakes, wind, flood, legal liability and other relatively straightforward potential causes of loss. Solutions involving the purchase of insurance were emphasized, with focus on type of coverage, adequacy of limits and cost of risk transfer. Over the last thirty years, most major corporations have evolved a much more sophisticated view of risk management, encompassing traditional risk management concerns and adding new issues arising from the changing internal and external environments within which they work. Now, it is understood that every aspect of a company's operational and financial activity contains the potential for risk that can negatively and meaningfully affect the success and viability of the organization.

Risk basically refers to the variations in the outcomes that could occur over a specified period in a given situation. If only one outcome is possible, the variation and hence the risk is zero. If many outcomes are possible, the risk is not zero. The greater the variation, the greater the risk.

Risk may also be defined as the possibility that an event will occur and adversely affect the achievement of the Company's objectives and goals. A business risk is the threat that an event or action will adversely affect an organisation's ability to achieve its business objectives/targets. Business risk arises as much from the possibility that opportunities will not be realised as much from the fact that certain threats could well materialize and that errors could well be made.

RISK CLASSIFICATION

Risks may be broadly classified under the following heads:

(a) Industry & Services Risks:

These risks can be broadly categorised as follows, namely :

- Economic risks such as dependence on one product, one process, one client, one industry, etc. in the short and long term.
- Services risks
- Market structure
- Business dynamics
- Competition risks affecting tariffs prices, costs, revenues and customer preferences
- Customer relations risks
- Reputational risk

(b) Management and Operations Risks:

These risks relate broadly to the company's organisation and management such as planning, monitoring, and reporting systems in the day to day management process namely:

- Risks to Property
- Clear and well defined work processes
- Changes in Technology/upgradation
- R&D risks
- Agency Network Risks
- Personnel risks such as labour turnover risks involving replacement risks, training risks, cost risks, skill risks etc. There are also unrest risks due to strikes and lockouts. These risks affect the company's business and earnings.
- Environmental and Pollution Control regulations, etc.
- Locational benefits near metros, railway stations, ports, cities, etc.

(c) Market Risks:

These risks relate to market conditions namely:

- Raw material rates
- Quantities, quality, suppliers, lead time, interest rates risks and forex risks namely, fluctuation risks and interest rate risk in respect of foreign exchange transactions.

(d) Political Risks:

These risks relate to political uncertainties namely:

- Elections
- War risks
- Country/Area risks
- Insurance risks like fire, strikes, riots and civil commotion, marine risks, cargo risks, etc.
- Fiscal/Monetary Policy Risks including Taxation risks.

(e) Credit Risks:

These risks relate to commercial operations namely:

- Creditworthiness risks
- Risks in settlement of dues by clients
- Provisions for doubtful and bad debts

(f) Liquidity Risks:

These are financial risk factors namely:

- Financial solvency and liquidity risks
- Borrowing limits, delays
- Cash/Reserve management risks
- Tax risks.

(g) Disaster Risks:

These risks relate to disasters from following factors:

- Natural risks like fires, floods, earthquakes, etc.
- Man-made risks arising under the Factories Act, Mines Act, etc.
- Risk of failure of effective Disaster Management plans formulated by the company.

(h) Systems Risks:

These risks relate to the company's systems namely:

- System capacities
- System reliability
- Obsolescence risks
- Data Integrity risks
- Coordinating and Interface risks.

(i) Legal Risks:

These risks relate to the following:

- Contract risks
- Contractual Liability
- Frauds
- Judicial risks
- Insurance risks.

RISK MANAGEMENT PROCESS

Risk management is a structured, consistent and continuous process, applied across the organisation for the identification and assessment of risks, control assessment and exposure monitoring.

The objectives of the Company's risk management framework comprise the following:

- To identify, assess, prioritise and manage existing as well as new risks in a planned and coordinated manner.
- To increase the effectiveness of internal and external reporting structure.
- To develop a risk culture that encourages employees to identify risks and associated opportunities and respond to them with appropriate actions.

James Millar, CEO Ernst & Young Australia, observed that ‘...risk is a fundamental part of any business activity and how companies manage these risks, indeed “master” them, to a great extent, determines how well they will succeed in their undertakings and in accomplishing their overall objectives’.

All companies have express or implied objectives which ultimately contribute to the maximization of shareholder value. Risk management actively supports the achievement of those objectives. It is not a process for avoiding risk. Properly implemented risk management can actively allow a company to undertake activities that have a higher level of risk thereby achieving a greater benefit because risks have been identified, understood and well managed.

Organizations which do have risk management policies in place are rewarded by added premium in the market and shall be better placed to pursue objectives and opportunities with confidence.

Risk management can be seen as a tool for creating opportunities for the businesses as they develop during the risk management process. Moreover such opportunities arise also from the complementary effect of risk management with other business planning process.

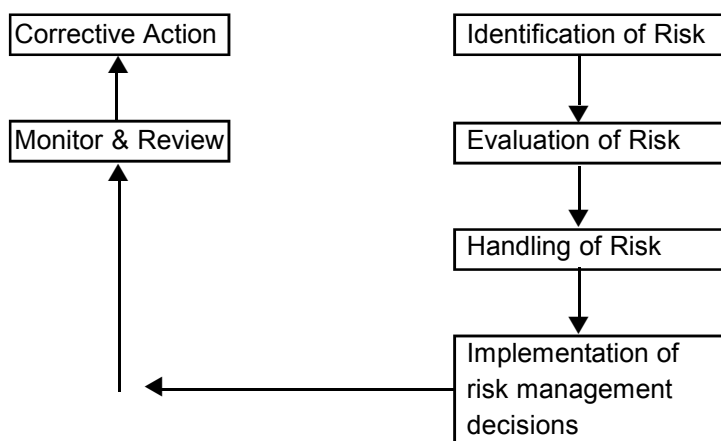
In other words, risk management is not just about preventing risks, but also managing it properly. However, managing risks properly does not mean becoming risk averse, or ignoring new opportunities for being “too risky”.

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.

STEPS IN RISK MANAGEMENT



1. Risk Identification

Any business exists in an atmosphere of perpetual change. Hence, the process of risk identification must be an ongoing one and any failure in proper risk identification would result in passive retention of the risk by the company. One is required to be alert to note the changes in environment and react.

Risk management requires following information for identification of risks—

- (a) Asset information such as list of assets, its original cost, book value, replacement value etc.
- (b) Process information regarding raw materials, process and nature of plant etc.,
- (c) Product information whether consumer products or industrial product, chances of liability etc.
- (d) Liability information such as liability to its stakeholders.

2. Risk Evaluation/Measurement

The risk measurement process requires a mathematical approach and considerable data on the past losses. The data available from the concern itself may not be adequate enough to lend itself amenable to analytical exercise. Hence, it becomes necessary to resort to data on industry basis, at national and sometimes even at international level. Risk evaluation includes the determination of:

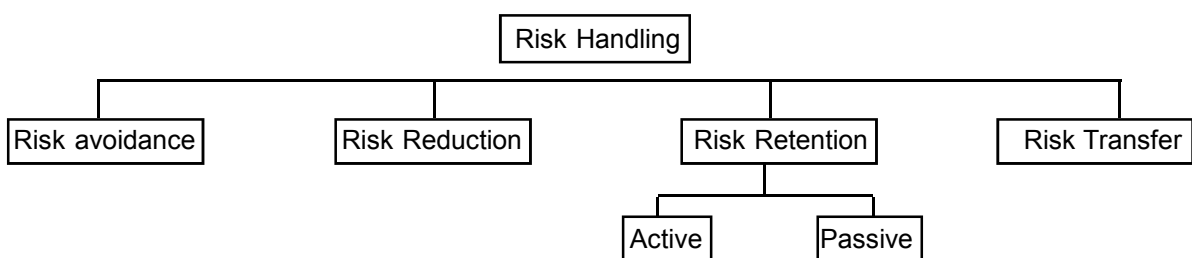
- (a) The probability or chances that losses will occur.
- (b) The impact the losses would have upon the financial affairs of the firm should they occur.
- (c) The ability to predict the losses that will actually occur during the budget period.

There are various statistical methods of quantifying risks. But the statistical methods are too technical and the risk manager then relies on his judgment. Risks are classified as modest, medium, severe etc. In either event, a 'risk matrix' can be prepared which essentially classifies the risks according to their frequency and severity.

3. Risk Handling

Firms are not entirely free to decide on how they shall handle their risks. In every country there are governmental and official regulations governing health and safety at work like fire precautions, hygiene, environmental pollution, food, handling of dangerous substances and many other matters relating to properties, personal injuries and other risks. The Central Government and State Governments have enacted compulsory insurance regulations (for vehicles and individuals). And in addition a firm may be obliged to insure certain risks under provisions of leases, construction and other contracts. Failure to comply with both safety and compulsory insurance regulations may constitute a criminal offence and may lead to the closure of a plant or other establishments. Thus, if a firm wishes to carry on certain activities it must comply with the relevant official risk handling regulations. There will remain, however, broad areas where it can exercise its own discretion to control physical or financial loss.

Risks can be handled broadly in four ways:



Risk Avoidance

It is a rare possibility to avoid a risk completely. A riskless situation is rare. Generally risk avoidance is only feasible at the planning stage of an operation.

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. Again, 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 only 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 Retention

It is also known as risk assumption or risk absorption. It is the most common risk management technique. This technique is used to take care of losses ranging from minor to major break-down of operation. There are two types of retention methods for containing losses as under:

- (i) Risk retained as part of deliberate management strategy after conscious evaluation of possible losses and causes. This is known as active form of risk retention.
- (ii) Risk retention occurred through negligence. This is known as passive form of risk retention.

Risk Transfer

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

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

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

4. Implementation of Decision

The last step in the risk management process is the implementation of the decision. The Risk Manager should recommend to the Board or an organization various alternatives of tackling the risks. After getting it approved, initiate measures to implement it.

Systematic approach to risk management requires an integration of different disciplines and holistic assessment techniques. It is desirable to have a generic approach to risk assessment that avoids compartmentalization or castling of risks.

ISO 31000

ISO 31000 published as a standard 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 - as a family of risk management standards - is not developed for a particular industry group, management system or subject matter field in mind, rather to provide 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 to 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.

ADVANTAGES OF RISK MANAGEMENT

Properly implemented risk management has many potential advantages to an organization in the form of:

- Better informed decision making - for example in assessing new opportunities;
- Less chances of major problems in new and ongoing activities; and
- Increased likelihood of achieving corporate objectives.

Risk management is the culmination of decision taken to improve corporate governance. Organizations that actively manage their risks have a better chance of achieving their objectives and preventing major problems happening.

Risk Management should not be seen as the responsibility of any particular unit/ department rather must be seen as an enterprise wide activity.

FRAUD RISK MANAGEMENT

According to the Collins English Dictionary 10th Edition fraud can be defined as: “deceit, trickery, sharp practice, or breach of confidence, perpetrated for profit or to gain some unfair or dishonest advantage”. In the broadest sense, a **fraud** is an intentional deception made for personal gain or to damage another individual.

The term ‘fraud’ is generally defined in the law as an intentional misrepresentation of material existing fact made by one person to another with knowledge of its falsity and for the purpose of inducing the other person to act, and upon which the other person relies with resulting injury or damage.

Section 25 of Indian Penal Code, 1860 defines “Fraudulently”. It says “A person is said to do a thing fraudulently if he does that thing with intent to defraud but not otherwise.”

Fraud can occur internally or externally by employees or third party.

For the corporate it becomes more important to proactively incorporate Fraud Management policy or a plan aligned to its internal control and risk management plan. 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:

- Promote an open and transparent communication culture
- Promote zero tolerance to fraud / misconduct
- Encourage employees to report suspicious cases of fraud / misconduct
- 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.

Fraud Disaster

After successful presence for over 230 years Barings Bank collapsed on February 26, 1995, due to the activities of one trader, Nick Leeson, who lost £827 million (\$1.3 billion).

The bank had successful existence with good clientage including the members from the royal family. The bank had faced bankruptcy in the year 1890 due the significant losses from investment in South America

following the Argentinean Revolution. At that time it was bailed out by a consortium organized by the governor of the Bank of England.

Despite surviving the Panic of 1890 and both World Wars, Barings was brought down in 1995 due to unauthorized trading by its head derivatives trader in Singapore, Nick Leeson.

Board of the Bank decided to enter the field of derivatives to make good profits and therefore decided to establish Baring Futures (Singapore) Pte Ltd ("BFS") which was incorporated on 17 September 1986. Nick Leeson a young trader was sent to Singapore to handle the arbitrage business, was tasked to make profit from differences in the prices of Nikkei 225 futures contracts listed on the Osaka Securities Exchange in Japan and the Singapore International Monetary Exchange. Such arbitrage involves buying futures contracts on one market and simultaneously selling them on another at a higher price.

However, instead of buying on one market and immediately selling on another market for a small profit, which was the strategy approved by his superiors, Leeson bought on one market then held on to the contract, gambling on the future direction of the Japanese markets. Leeson kept unmatched position and he was able to conceal his unauthorised trading activities for over a year because he managed both the trading and back office settlement functions.

Because of the absence of oversight, Leeson continued booking various losses on the account "88888" specifically created by him for holding premiums or losses that he made and further continued to increase his volume of trading and level of risk taking.

He falsified trading records in the bank's computer systems, and used money intended for margin payments on other trading. As a result, he appeared to be making substantial profits. However, Kobe earthquake (23 January 1995) in Japan caused a steep drop in the Nikkei 225 equity index, and his unauthorised trading positions suffered huge losses.

Leeson's activities had generated losses totalling £827 million (US\$1.3 billion), twice the bank's available trading capital. ING, a Dutch bank, purchased Barings Bank in 1995 for the nominal sum of £1 and assumed all of Barings' liabilities, forming the subsidiary ING Barings.

To sum up, it can indicate the major reasons of the collapse of Barings:

1. **Lack of internal checks and balances-** There was clear concentration of power in the Leeson's hands who was handling both the trading and back office settlement functions.
2. **Poor supervision of employees-** There seemed to have little oversight of his activities and no individual was directly responsible for monitoring his trading strategies.

Lord Bruce of Donington, in the House of Lords' debate on the report released on 18 July 1995, remarked "Barings' collapse was due to the unauthorised and ultimately catastrophic activities of, it appears, one individual (Leeson) that went undetected as a consequence of a failure of management and other internal controls of the most basic kind".

REPUTATION RISK MANAGEMENT

Reputation is the trust that an organization has gained over the years by the products, services, brands it has provided to the society. Corporates are at a risk of losing such reputation, reputation damage are irreparable. It is an intangible asset that is broad and far-reaching and includes image, goodwill and brand equity. If ruined can devastate the financial health and welfare of an organization.

Reputation lost will damage:

- Brand Value

- Share Price
- Strategic Relationship
- Regulatory relationship
- Recruitment/ Retention

Be it Sportswear giant Nike being caught in a child labour scandal or Perrier bottled water being supplied with carcinogenic benzene impurities; all such events embarrass the company in front of its stakeholders. Organizations are required to handle such situations wisely.

Components of Reputation Risk Management

- Management of Reputation Risk
- Preparation for Reputation Crises
- Handling of Reputation Crises

NON-COMPLIANCE RISK MANAGEMENT

Secretarial Audit is a compliance audit and it is a part of total compliance management in an organisation. The Secretarial Audit is an effective tool for corporate compliance management. It helps to detect non-compliance and to take corrective measures.

The multiplicity of laws, rules, regulations, etc. has necessitated introduction of a compliance management system to ensure compliances of laws applicable to a company. This has a two-fold objective:

- (a) Firstly, to protect the interests of all the stakeholders;
- (b) Secondly, to avoid any legal actions against the company and its management.

Under most laws, the persons responsible for compliance and liable for punishment are directors, company secretary and the officers who have been designated for specific compliances. From amongst the directors, the responsibility of managing and whole-time directors is greater. Under the Companies Act, a managing and/or whole-time director (besides company secretary) is an officer who is in default liable for penal consequences of defaults and thus responsible for compliance, while under most other laws they are the persons in charge of, and responsible to, the company for the conduct of the business of the company.

In India, a number of statutes contain under the heading “Offences by Companies” an identical provision regarding vicarious liability of directors and other company officers for company’s offences. In *Girdhari Lal Gupta v. D.N. Mehta* AIR 1971 SC 2162, the Supreme Court has construed the expression a person in charge and responsible for the conduct of the business of the company’ as to mean the person in overall control of the day-to-day business of the company. This ruling has been followed in a number of subsequent decisions.

Sub Clause 49(VI) of the Listing Agreement provides:

- A. The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures.
- B. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.
- C. The company shall also 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.

SECRETARIAL AUDIT & COMPANY SECRETARY IN PRACTICE (PCS)

Section 204 of the Companies Act 2013, provides following with respect to Secretarial Audit:

- (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.
- (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

A significant area of competence of PCS is "Corporate laws" (comprising statutes, rules, regulations, notifications, circulars and clarifications, forms, guidelines and bye-laws) owing to intensive and rigorous coaching, examinations, training and continuing education programs. PCS is a highly specialized professional in matters of statutory, procedural and practical aspects involved in proper compliances under corporate laws. Strong knowledge base makes PCS a competent professional to conduct Secretarial Audit.

A Company Secretary in Practice has been assigned the role of Secretarial Auditor in section 2(2)(c)(v) of the Company Secretaries Act, 1980.

In order to guide its members with the process of Secretarial Audit, the Institute of Company Secretaries of India has issued a Referencer on Secretarial Audit.

Secretarial Audit Process

Secretarial Audit is a process to check compliance with the provisions of various laws and rules/ regulations/ procedures, maintenance of books, records etc., by an independent professional to ensure that the company has complied with the legal and procedural requirements and also followed due processes. It is essentially a mechanism to monitor compliance with the requirements of stated laws.

Benefits of Secretarial Audit are manifold. Ever-increasing complexities of laws and responsibilities of directors (especially non-executive directors) make it imperative that a PCS reports whether or not there exists proper compliance mechanism and systems in the corporate structure. PCS has also to verify whether diverse requirements under applicable laws have been duly complied with or not and if there is a need for any corrective measures or improvement in the system.

Beneficiaries of Secretarial Audit

The major beneficiaries of Secretarial Audit include:

(a) Promoters

Secretarial Audit will assure the Promoters of a company that those in-charge of its management are conducting its affairs in accordance with requirements of laws.

(b) Management

Secretarial Audit will assure the Management of a company that those who are entrusted with the duty

and responsibility of compliance are performing their role effectively and efficiently. This also helps the management to establish benchmarks for the compliance mechanism, review and improve the compliances on a continuing basis.

(c) Non-executive directors

Secretarial Audit will provide comfort to the Non-executive Directors that appropriate mechanisms and processes are in place to ensure compliance with laws applicable to the company, thus mitigating any risk from a regulatory or governance perspective; so that the Directors not in-charge of the day-to-day management of the company are not likely to be exposed to penal or other liability on account of non-compliance with law.

(d) Government authorities / regulators

Being a pro-active measure, Secretarial Audit facilitates reducing the burden of the law-enforcement authorities and promotes governance and the level of compliance.

(e) Investors

Secretarial Audit will inform the investors whether the company is conducting its affairs within the applicable legal framework.

(f) Other Stakeholders

Financial Institutions, Banks, Creditors and Consumers are enabled to measure the law abiding nature of Company management.

Corporate conduct manifesting good Corporate Governance is vital for the healthy, vibrant and ever growing corporate sector in global economy. In developing economies, inclusive growth of all segments of society is more than imperative. Adopting effective management tools like Secretarial Audit can go a long way in fulfilling these objectives.

RESPONSIBILITY OF RISK MANAGEMENT

The board is responsible for reviewing the company's policies on risk oversight and management and satisfying itself that management has developed and implemented a sound system of risk management and internal control.

The entire programme must be supported by the board of directors. In modern corporations the board desirably has a risk management committee which controls the overall picture of the uncertainty facing the company. This is because risks are interconnected and interdependent. The approach 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.

The role of the board in risk management has been well highlighted in the King Code of Governance for South Africa 2009 as well as the UK Corporate Governance Code

King Code of Governance for South Africa 2009 (King III)

Principle 1.7: The board should be responsible for the process of risk management

The board's role is to set a risk appetite or risk tolerance level for the company. This should be determined according to the strategy adopted by the company and should take into account sustainability, ethics and compliance risks.

The board should oversee the identification of the key risk areas of the company and ensure that the management directs its mind to pertinent risks. These identified risks should be assessed for likelihood and magnitude of potential effect.

The board should be actively involved in identifying and monitoring the key risks emanating from this process. Where appropriate, a risk committee should be established.

The board's ultimate responsibility for the process of risk management should be expressed in its board charter and supported by training and induction processes.

The board has an obligation to demonstrate that it has dealt comprehensively with the issues of risk management. This requires appropriate disclosure on matters such as risk tolerance and the risk management process in the integrated report.

UK Corporate Governance Code

Main Principle: The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

Code Provision: C.2.1 The board should, at least annually, conduct a review of the effectiveness of the company's risk management and internal control systems and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls.

Non-executive Directors (NEDs) should satisfy themselves on the integrity of financial information and that financial controls and systems of Risk Management are robust and defensible.

Role of Company Secretary

As 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 officer responsible for coordination and communication for effective corporate functioning and 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?

SEGMENT II- INTERNAL CONTROL SYSTEM

Reasonable assurance is a concept that acknowledges that control systems should be developed and implemented to provide management with the appropriate balance between risk of a certain business practice and the level of control required to ensure business objectives are met.

A system of internal control is a proactive approach that balances the risk and control in the Company which helps in exploiting business opportunities fully. An effective control system provides reasonable, but not absolute assurance for the safeguarding of assets, the reliability of financial information, and the compliance with laws and regulations. It provides management with the appropriate balance between risk of a certain business practice and the level of control required to ensure business objectives are met.

The system of internal control facilitates the effectiveness and efficiency of operations, helps ensure the reliability of internal and external reporting and assists in compliance with laws and regulations. Effective financial controls, including the maintenance of proper accounting records, are an important element

of internal control. They help to ensure that a company is not unnecessarily exposed to avoidable financial risks and that the financial information used within the business and for publication is reliable. They also contribute to the safeguarding of assets, including the prevention and detection of fraud.

Elements of sound internal control system as prescribed under Internal Control Revised Guidance for Directors on the Combined Code October, 2005 – Nigel Turnbull

An internal control system encompasses the policies, processes, tasks, behaviours and other aspects of the Company that, taken together:

- facilitates its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieve the Company's objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud and ensuring that liabilities are identified and managed;
- helps to ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organisation;

- helps ensure compliance with applicable laws and regulations, and also internal policies with respect to conducting business.

The system of internal control should:

- be embedded in the operations of the company and form part of its culture;
- be capable of responding quickly to evolving risks to the business arising from factors within the company and to changes in the business environment; and
- include procedures for reporting immediately to appropriate levels of management any significant control failings or weaknesses that are identified together with details of corrective action being undertaken.

A company's objectives, its internal organisation and the environment in which it operates are continually evolving and, as a result, the risks it faces are continually changing. In order to make its internal control effective and sound, a Company thoroughly and regularly evaluates the nature and extent of the risks to which it is exposed.

The system will include:

- control activities;
- information and communications processes; and
- processes for monitoring the continuing effectiveness of the system of internal control.

A sound system of internal control reduces, but cannot eliminate, the possibility of poor judgement in decision-making; human error; control processes being deliberately circumvented by employees and others; management overriding controls; and the occurrence of unforeseeable circumstances.

A sound system of internal control therefore provides reasonable, but not absolute, assurance that a company will not be hindered in achieving its business objectives, or in the orderly and legitimate conduct of its business, by circumstances which may reasonably be foreseen. A system of internal control cannot, however, provide protection with certainty against a company failing to meet its business objectives or all material errors, losses, fraud, or breaches of laws or regulations.

INTERNAL CONTROL DEFINED

Internal control is defined as a process, effected by an organization's people and information technology (IT) systems, designed to help the organization accomplish specific goals or objectives.

It is a means by which an organization's resources are directed, monitored, and measured. It plays an important role in preventing and detecting fraud and protecting the organization's resources, both physical (e.g., machinery and property) and intangible (e.g., reputation or intellectual property such as trademarks).

At the organizational level, internal control objectives relate to the reliability of financial reporting, timely feedback on the achievement of operational or strategic goals, and compliance with laws and regulations.

At the specific transaction level, internal control refers to the actions taken to achieve a specific objective (e.g., how to ensure the organization's payments to third parties are for valid services rendered.) Internal control procedures reduce process variation, leading to more predictable outcomes.

An effective internal control system balances the risk and control and helps a company in exploiting business opportunity fully.

Internal controls are put in place to keep the company on course toward profitability goals and achievement of its mission, and to minimize surprises along the way. They enable management to deal with rapidly changing economic and competitive environments, shifting customer demands and priorities, and restructuring for future growth. Internal controls promote efficiency, reduce risk of asset loss, and help ensure the reliability of financial statements and compliance with laws and regulations.

Internal Control Revised Guidance for Directors on the Combined Code October, 2005– Nigel Turnbull

The importance of internal control

1. A company's system of internal control has a key role in the management of risks that are significant to the fulfilment of its business objectives. A sound system of internal control contributes to safeguarding the shareholders' investment and the company's assets.
2. Internal control facilitates the effectiveness and efficiency of operations, helps ensure the reliability of internal and external reporting and assists compliance with laws and regulations.
3. Effective financial controls, including the maintenance of proper accounting records, are an important element of internal control. They help ensure that the company is not unnecessarily exposed to avoidable financial risks and that financial information used within the business and for publication is reliable. They also contribute to the safeguarding of assets, including the prevention and detection of fraud.
4. A company's objectives, its internal organisation and the environment in which it operates are continually evolving and, as a result, the risks it faces are continually changing. A sound system of internal control therefore depends on a thorough and regular evaluation of the nature and extent of the risks to which the company is exposed. Since profits are, in part, the reward for successful risk-taking in business, the purpose of internal control is to help manage and control risk appropriately rather than to eliminate it.

COSO Definition of Internal Control

Committee of Sponsoring Organizations of the Treadway Commission (COSO) is a U.S. private sector initiative. COSO has defined internal controls as "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"

Fundamental Concepts from definition - Internal control is:

- *Geared to the achievement of objectives* in one or more categories—operations, reporting, and compliance
- *A process* consisting of ongoing tasks and activities—a means to an end, not an end in itself
- *Effected by people*—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 affect internal control
- *Able to provide reasonable assurance*—but 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

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.

In March, 2013 COSO has introduced its updated *Internal Control—Integrated Framework (Framework)*.

Objectives

The Framework provides for three categories of objectives, which allow organizations to focus on differing aspects of internal control:

- (i) *Operations Objectives*—These pertain to effectiveness and efficiency of the entity's operations, including operational and financial performance goals, and safeguarding assets against loss.
- (ii) *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, recognized standard setters, or the entity's policies.
- (iii) *Compliance Objectives*—These pertain to adherence to laws and regulations to which the entity is subject.

Components of Internal Control

Internal control consists of five interrelated components. These are derived from the way management runs a business, and are integrated with the management process. The components are:

- (i) **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.
- (ii) **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.
- (iii) **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.
- (iv) **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.
- (v) **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.

Relationship of Objectives and Components

A direct relationship exists between objectives,

COSO's Internal Control - Integrated Framework

which are what an entity strives to achieve, components, which represent what is required to achieve the objectives, and the organizational structure of the entity (the operating units, legal entities, and other). The relationship can be depicted in the form of a cube.

The three categories of objectives—operations, reporting, and compliance—are represented by the columns.

The five components are represented by the rows. An entity's organizational structure is represented by the third dimension.



COSO's Internal Control - Integrated Framework

Components and Principles

The Framework sets out seventeen principles representing the fundamental concepts associated with each component. Because these principles are drawn directly from the components, an entity can achieve effective internal control by applying all principles. All principles apply to operations, reporting, and compliance objectives. The principles supporting the components of internal control are listed below:

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.

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.

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.

Information and Communication

- The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.
- The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.
- The organization communicates with external parties regarding matters affecting the functioning of internal control.

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.



Internal control consists of five interrelated components. True or False?

Implementation of Internal Control System

Everyone in an organization has responsibility for internal control. From Board and management level to operational levels in the organization, everybody is responsible for its successful implementation.

ROLE AND RESPONSIBILITIES WITH REGARD TO INTERNAL CONTROL

Management

It is the role of management to implement board policies on risk and control. In fulfilling its responsibilities management should identify and evaluate the risks faced by the company for consideration by the board and design, operate and monitor a suitable system of internal control which implements the policies adopted by the board.

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.

Clause 49 (IX) of Listing Agreement: The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that:

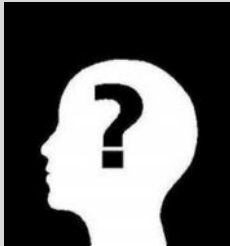
- A. They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief:
 1. these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
 2. these statements 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.

Accordingly, it is the responsibility of CEO and CFO to:

- (a) Establish and maintain the internal controls;
- (b) Evaluate effectiveness of internal control system. The assessment of internal control system has to be made using recognized framework.
- (c) Disclose deficiencies in the design or operation of internal controls they are aware of;
- (d) Take steps to rectify the deficiencies in the internal control system;
- (e) Inform auditors and Audit Committee of any significant changes in the internal control system and significant fraud if any of which they have become aware.

Management is accountable to the Board of Directors, which provides governance, guidance and oversight. The internal control system is normally judged by the management’s commitment to internal audit and process audit function. To be effective, the internal audit function should have financial experts, Control experts, IT experts and persons with the knowledge of organisation business.

While law casts the responsibility on CEO and CFO for the financial aspects of internal control, everyone in an organization has responsibility for internal control.



CEO/CFO certificate under Clause 49 requires certification from Practicing Company Secretary? True or False.

Board of Directors

A strong, active Board, particularly when coupled with effective upward communication channels and capable financial, legal and internal audit functions, is often the best-needed framework for internal control effectiveness and adequacy.

The board of directors is responsible for the company's system of internal control. It should set appropriate policies on internal control and seek regular assurance that will enable it to satisfy itself that the system is functioning effectively. The board must further ensure that the system of internal control is effective in managing those risks in the manner which it has approved.

In determining its policies with regard to internal control, and thereby assessing what constitutes a sound system of internal control, the board's deliberations should include consideration of the following factors:

- the nature and extent of the risks facing the company;
- the extent and categories of risk which it regards as acceptable for the company to bear;
- the likelihood of the risks concerned materialising;
- the company's ability to reduce the incidence and impact on the business of risks that do materialise; and
- the costs of operating particular controls relative to the benefit thereby obtained in managing the related risks.

Reviewing the effectiveness of internal control is an essential part of the board's responsibilities. The board will need to form its own view on effectiveness based on the information and assurances provided to it, exercising the standard of care generally applicable to directors in the exercise of their duties. Management is accountable to the board for monitoring the system of internal control and for providing assurance to the board that it has done so.

Effective monitoring on a continuous basis is an essential component of a sound system of internal control. The board cannot, however, rely solely on the embedded monitoring processes within the company to discharge its responsibilities. It should regularly receive and review reports on internal control.

In addition, the board should undertake **an annual assessment for the purposes of making its public statement in the Management Discussion and Analysis Report** on internal control to ensure that it has considered all significant aspects of internal control for the company for the year under review and up to the date of approval of the annual report and accounts.

The board should define the process to be adopted for its review of the effectiveness of internal control. This should encompass both the scope and frequency of the reports it receives and reviews during the year, and also the process for its annual assessment, such that it will be provided with sound, appropriately documented, support for its statement on internal control in the company's annual report and accounts.

The board's annual assessment should, in particular, consider:

- the changes since the last annual assessment in the nature and extent of significant risks, and the company's ability to respond to changes in its business and the external environment;
- the scope and quality of management's ongoing monitoring of risks and of the system of internal control, and, where applicable, the work of its internal audit function and other providers of assurance;
- the incidence of significant control failings or weaknesses that have been identified at any time during the period and the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the company's financial performance or condition; and
- the effectiveness of the company's public reporting processes.

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;

ICSI Recommendations to strengthen Corporate Governance Framework and Secretarial Standard on Board Report (SS-10) provide that Directors' Responsibility Statement should include a statement that the directors had devised proper systems to ensure compliance of all laws applicable to the company and that such systems were adequate and operating effectively

Corporate Governance Voluntary Guidelines, 2009

E. Board to place Systems to ensure Compliance with Laws

- (i) In order to safeguard shareholders' investment and the company's assets, the Board should, at least annually, conduct a review of the effectiveness of the company's system of internal controls and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems.
- (ii) The Directors' Responsibility Statement should also include a statement that proper systems are in place to ensure compliance of all laws applicable to the company. It should follow the “comply or explain” principle.

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. Section 138 of Companies Act, 2013 provides that:

- (1) Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

- (2) The Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.

Employees

All employees have some responsibility for internal control as part of their accountability for achieving objectives. They, collectively, should have the necessary knowledge, skills, information, and authority to establish, operate and monitor the system of internal control. This will require an understanding of the company, its objectives, the industries and markets in which it operates, and the risks it faces.

In an organization, internal control is the responsibility of everyone and it should be a part of everyone's job description. All employees produce information used in the internal control system or take other actions needed to effect control. Also, all personnel should be responsible for communicating upward problems in operations, noncompliance with the code of conduct, or other policy violations or illegal actions.

A number of external parties often contribute to achievement of an entity's objectives. External auditors, bringing an independent and objective view, contribute directly through the financial statement audit and indirectly by providing information useful to management and the board in carrying out their responsibilities. Others providing information to the entity useful in effecting internal control are legislators and regulators, customers and others transacting business with the enterprise, financial analysts, rating agencies and the news media. External parties, however, are not responsible for, nor are they a part of, the entity's internal control system.

CONCLUSION

Internal control can help an entity to achieve its performance and profitability targets, and prevent loss of resources. It can help ensure reliable financial reporting. It can help to ensure that the enterprise complies with laws and regulations, avoiding damage to its reputation and other consequences. It helps an entity achieve its goals, and avoid pitfalls and surprises along the way.

Even effective internal control can only help an entity achieve these objectives. It can provide management information about the entity's progress, or lack of it, toward their achievement. But internal control cannot change an inherently poor manager into a good one. Shifts in government policy or programs, competitors' actions or economic conditions can be beyond management's control. Internal control cannot ensure success, or even survival.

Internal control can ensure the reliability of financial reporting and compliance with laws and regulations.

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 may be defined as the possibility that an event will occur and adversely affect the achievement of the Company's objectives and goals.
- Risk may be defined as the possibility that an event will occur and adversely affect the achievement of the Company's objectives and goals.
- Risk management is a structured, consistent and continuous process, applied across the organisation for the identification and assessment of risks, control assessment and exposure monitoring.
- Corporates should act proactively by incorporating Fraud Management policy or a plan aligned to its internal control and risk management plan.
- Reputation is an intangible asset including image, goodwill and brand equity. If ruined can devastate the financial health and welfare of an organization.
- Risk management is the culmination of decision taken to improve corporate governance. Organizations that actively manage their risks have a better chance of achieving their objectives and preventing major problems happening.
- The process of risk management consists of four logical and sequential steps: Identification of risk; (ii) Evaluation/measurement of risks; (iii) Handling of risks and (iv) Implementation of risk management decisions.
- The board is responsible for reviewing the company's policies on risk oversight and management and satisfying itself that management has developed and implemented a sound system of risk management and internal control
- As a top level officer and board confidante, a Company Secretary shall be responsible for sound Enterprise wide Risk Management [ERM] which is effective throughout the company
- A system of internal control balances the risk and control in the Company helps in exploiting business opportunities fully.
- An internal control system encompasses the policies, processes, tasks, behaviours and other aspects of a company.
- Internal control is defined as a process, effected by an organization's people and information technology (IT) systems, designed to help the organization accomplish specific goals or objectives.
- COSO is the acronym for Committee of Sponsoring Organizations of the Treadway Commission.
- The components of the COSO's Integrated Internal Control Framework are Control Environment, Risk Assessment, Control Activities, Information and Communication, Monitoring.
- Management is accountable to the Board of Directors, which provides governance, guidance and oversight. A strong, active Board, particularly when coupled with effective upward communication channels and capable financial, legal and internal audit functions, is often the best-needed framework for internal control effectiveness and adequacy.
- Internal control can help an entity to achieve its performance and profitability targets, and prevent loss of resources. It can help ensure reliable financial reporting. And it can help to ensure that the enterprise complies with laws and regulations, avoiding damage to its reputation and other consequences.

Lesson 10

Corporate Governance in Banks, Insurance And Public Sector Companies

LESSON OUTLINE

- Introduction
- Classification of Banks
- Regulation of Banks
- Board Composition in Banks
- Constitution of Committees
- Nationalised Banks (Management and Miscellaneous Provisions) Scheme, 1970
- Governance in Insurance Companies
- Corporate Governance in Public Sector Enterprises
- Guidelines on CSR and Sustainability for CPSEs
- Conclusion
- 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 Insurance companies are also subject to compliance with IRDA guidelines 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.

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

“We have now moved from diversified ecology of small banks, with varied lending policies, to a more homogeneous from work of firms that all resemble one another”

– Nassim Nicholas Taleb

INTRODUCTION

The economic development of a country in the modern age can be judged from the efficiency of its banking system. They are central to market development and socio-economic growth, regulatory and economic reforms. Banks have an especially important role in any economy. First and foremost, they accept deposits from and are liable to the general public. These deposits constitute a significant portion of a nation's wealth, and must therefore be managed appropriately.

Banks are different from other corporates in many important respects, and that makes corporate governance of banks not only different but also more critical. By the very nature of their business, banks are highly leveraged. They accept large amounts of public funds as deposits in a fiduciary capacity and further leverage those funds through credit creation. The presence of a large and dispersed base of depositors in the stakeholders group sets banks apart from other corporates.

If a corporate fails, the fallout can be restricted to the stakeholders. If a bank fails, the impact can spread rapidly through to other banks with potentially serious consequences for the entire financial system and the macro economy.

Classification of Banks

In the Indian context, banks can be classified as Scheduled Bank and Unscheduled Bank. Scheduled Banks expressed as Scheduled Commercial Banks (SCBs) which can be further grouped as State Banks Group and other Nationalized Banks, Foreign Banks, Regional Rural Banks and other Scheduled Commercial Banks.

Once the name of a bank is included in the Second Schedule to the Reserve Bank of India Act, 1934, it is called a Scheduled Bank. A Scheduled Bank is entitled to facilities of refinance from RBI, subject to fulfillment of the following conditions laid down in Section 42 (6) of the Act, as follows:

- it must have paid-up capital and reserves of an aggregate value of not less than an amount specified from time to time; and
- it must satisfy RBI that its affairs are not being conducted in a manner detrimental to the interests of its depositors.

For the purpose of assessment of performance of banks, the Reserve Bank of India categories them as public sector banks, old private sector banks, new private sector banks and foreign 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. A merger reduced the number from 20 to 19. The State Bank of India was nationalized in 1955 under the SBI Act of 1955.

Nationalized banks are wholly owned by the Government, although some of them have made public issues. Nationalized banks are not registered under the Companies Act, 2013 and therefore the Companies Act does not apply to them.

Regulation of Banks

The Reserve Bank of India, the central bank of the country, is the primary regulator of banks. The Banking Regulation Act, 1949 applies to all banks. The provisions of this Act shall be in addition to, and not, unless expressly provided, in derogation of the Companies Act, 2013 and any other law for the time being in force. Companies Act, 2013 is applicable to all private sector banks registered under the Companies Act, 2013.

Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and 1980 is applicable to all nationalized banks except State Bank of India, which is governed by the State Bank of India Act.

Additionally all listed banks are required to comply with the listing agreement except where the provisions are not in conformity with directives of Reserve Bank of India or the Act as applicable to a respective bank.

In this study lesson we will study the Corporate governance norms (other than the Listing Agreement) applicable to Public sector and private sector banks.

Board Composition

In terms of Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, which is applicable to nationalised banks, the Board Composition shall include-

- (a) not more than two 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. Such Director shall not be a Director of any other nationalized bank.
- (c) one Director who is an officer of the Reserve Bank to be nominated by the Central Government on the recommendation of the Reserve Bank.
- (d) not more than two Directors to be nominated by the Central Government from amongst the Securities Exchange Board of India established under Section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the National Bank for Agriculture and Rural Development established under Section 3 of the National Bank for Agriculture and Rural Development Act, 1981 (16 of 1981), public financial institutions as specified in sub-section (1), or notified from time to time under sub-section (2), of Section 2(72) of the Companies Act, 2013 and other institutions established or constituted by or under any Central Act or incorporated under the Companies Act, 2013 and having not less than fifty-one per cent of the paid-up capital held or controlled by the Central Government;
- (e) one Director, from among such of the employees 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 who are not workmen 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 twenty per cent of the total paid-up capital, not more than two Directors,
 - (ii) more than twenty per cent but not more than forty per cent of the total paid-up capital, not more than four Directors,
 - (iii) more than forty per cent of the total paid-up capital, not more than six Directors, to be elected by the shareholders, other than the Central Government, from amongst themselves:

On the assumption of charge after election of any such Directors under this clause, equal number of Directors nominated under clause (h) shall retire in such manner as may be specified in the scheme.

The Directors to be nominated under clause (h) or to be elected under clause (i) of sub-section; (3A) 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.

In other words, in a nationalised bank, In addition to the Chairman and Managing Director and Executive Director(s), the Board should comprise the following Non Executive Directors:

1. Nominee of GOI – (Official of the Central Government);
2. Nominee of RBI – (Official of Reserve Bank of India);
3. Workmen Director – Representing the interest of Workmen of the Bank;
4. Non Workmen Director – Representing the interest of Officer of the Bank;
5. A Chartered Accountant with minimum 15 years experience—nominated by Government of India;
6. Not more than six directors – Nominated by Government of India – representing various areas of interest such as Finance, Economics, Banking, Artisan, Agriculture etc., or any other area considered useful to the bank by RBI.
7. Two, four or six Directors elected by Shareholders other than Central Government based on dilution of Government of India's shareholding in the Bank

NATIONALISED BANKS (MANAGEMENT AND MISCELLANEOUS PROVISIONS) SCHEME, 1970

In exercise of the powers conferred by Section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), the Central Government, after consultation with the Reserve Bank, makes this Scheme called as the Nationalised Banks (Management and Miscellaneous Provisions) Scheme, 1970.

The scheme deals with the manner of nomination of directors, retirement of nominee directors/excess elected directors, terms of office of Managing and other directors etc.

Terms of Officer for Whole Time Directors

The scheme provides that a whole-time Director, including the Managing Director, shall devote his whole time to the affairs of the Nationalised Bank and shall hold office for such term not exceeding five years and shall be eligible for re-appointment.

The Central Government shall have the right to terminate the term of office of a whole-time Director, including the Managing Director, at any time before the expiry of the term specified under that sub clause by giving to him notice of not less than three months in writing or three month's salary and allowances in lieu of notice; and the whole-time Director, including the Managing Director, shall also have the right to relinquish his office by giving to the Central Government notice of not less than three months in writing.

Disqualifications of Directors

The Scheme provides that a person shall be disqualified for being appointed as, and for being, a Director:

- If he has at any time been adjudicated an insolvent or has suspended payment or has compounded with his creditors; or
- If he has been found to be of unsound mind and stands so declared by a competent court; or
- If he has been convicted by a criminal court of an offence which involves moral turpitude.

Chairman

The Central Government shall, after consultation with the Reserve Bank, appoint one of the Directors to be the Chairman of the Board.

The Central Government may, after consultation with the Reserve Bank, appoint the same person to hold, at the same time, both the Offices of the Chairman and the Managing Director.

Meetings of the Board

Meeting of the Board shall ordinarily be held at least six times in a year and at least once in each quarter.

A meeting of the board shall be held at the head office of the Nationalised Bank or such other place as the board may decide.

Ordinarily, not less than fifteen days notice shall be given of any meeting of the board and such notice shall be sent to every Director at the address specified by him in this behalf.

Constitution of Committees

Some of the stipulated committees of the Board are as under:

- Management Committee of the Board
- Audit Committee: banks have to set up as required in terms of the RBI guidelines, independent Audit Committees. The Audit Committee comprises a majority of the independent / non-executive directors with the Executive Director of the bank as one of the members.
- Risk Management Committee
- Nomination Committee
- Committee of High Value Frauds
- IT Strategy Committee
- Remuneration Committee
- Credit Approvals Committee
- Customer Service Committee
- Committee of Directors
- Human Resources Committee

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 objective of the guidelines is to ensure that the structure, responsibilities and functions of Board of Directors and the senior management of the company fully recognize the expectations of all stakeholders as well as those of the regulator.

1. Composition of the Board

The Insurance Act stipulates that the insurance companies in India would be public companies and hence, would require a properly constituted Board.

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.

The Board of Directors is required to have a significant number of “Independent Directors”. 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.

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’.

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 come under adverse notice of the laws and regulations or of any professional body. With a view to ensuring that the Directors comply with the above requirement, a **due diligence inquiry** 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 format prescribed in the guidelines, at the time of their appointment/re-appointment.

The Directors are also required to enter into a **Deed of Covenant** as per the format prescribed in the guidelines, 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 and the Board in Corporate Governance.

2. 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.
- 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 insurance in particular and in the financial sector in general and for updating the Directors through formal and informal programmes covering regulatory systems, market growth trends, future strategic plans/operations, etc.

- The responsibility for the oversight of control functions (prescribed in the guidelines) of an insurer should be entrusted to Directors possessing the appropriate integrity, competence, experience and qualifications, and they should meet the fit and proper criteria initially and on an on-going basis.

3. 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.

4. Committees

The company can establish several Committees to undertake specific functions depending on the size and level of the complexity of the operations.

However, IRDA has advised 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.

Audit Committee:

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.

Investment Committee:

The Committee shall be responsible for laying down an overall investment policy and operational framework for the investment operations of the insurer.

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 IRDA within 30 days.

Investment Committee should comprise 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.

Risk Management Committee:

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.

Policyholder Protection Committee:

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.

Asset Liability Management Committee (in case of life insurers):

Asset Liability Management 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.

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.

CEO & OTHER SENIOR MANAGEMENT

CEO

Section 34A of the Insurance Act, 1938 requires prior approval of the IRDA for appointment, re-appointment or termination of the Chief Executive Officer and the Whole Time Directors. The Insurance Act also prohibits the CEO of a **life insurance company** from being a Director in any other insurance company/bank/investment company. Accordingly, the Board should take proactive steps to decide on the continuance of CEO well in time before the expiry of his tenure (at least a month before the completion of the tenure) or to identify the new incumbent.

Actuaries

IRDA (Appointed Actuary) Regulations, 2000, details the procedure for the appointment, qualifications, powers along with duties and obligations of the Actuary to be appointed in the company.

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. The statutory auditors recommended by the Audit Committee are required to be appointed at a general body meeting of the shareholders of the insurer. 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;
- At least one partner/employee should have CISA(*Certified Information Systems Auditor*/ISA (Information Systems Audit) 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).

Auditors, Actuaries, Directors and Senior Managers shall not simultaneously hold two positions in the insurance company that could lead to conflict or potential conflicts of interest.

Key Stakeholders

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. Towards protecting the interests of the various stakeholders the insurer must ensure complete transparency in operations and make periodic disclosures.

Whistle Blowing

The insurers shall 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 shall include employee reporting in confidence directly to the chairman of the board or of a committee of the board or to the external auditor.

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 Clause 49 of the SEBI Listing Agreement, it is now mandatory for all Central Public Sector Enterprises (CPSEs) to comply with the corporate governance norms rolled out by the Department of Public Enterprises.

However, there continues to be concerns around effective implementation of these norms. Autonomy of PSUs, functioning of the PSU boards, failure on the part of many listed PSUs (Navratnas and Miniratnas) to comply with Clause 49 of the SEBI Listing Agreement and the vast differences that exist between the governance standards prevalent in central and state PSUs are some of the key issues that should be resolved at the earliest by the Government through concerned Ministry. The appointment of Independent Directors and separation of roles of Chairman and Managing Directors is a matter of concern in the Public Sector Enterprises.

DPE Guidelines on Corporate Social Responsibility (CSR) and Sustainability for Central Public Sector Enterprises

Department of Public Enterprises (DPE) has issued New Guidelines on CSR and Sustainability for CPSEs w.e.f. April 1, 2013. The guidelines issued are in consonance with the National Voluntary Guidelines for Social, Environmental & Economic Responsibilities of Business issued by the Ministry of Corporate Affairs in July 2011.

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 marginalized 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 earlier guidelines focused 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.

As per the guidelines, Public Sector enterprises are required to have a CSR and Sustainability policy approved by their respective Boards of Directors. Each CPSE shall have a Board level committee headed by either the Chairman and / or Managing Director, or an Independent Director to oversee the implementation of the CSR and Sustainability policies of the Company and to assist the Board of Directors to formulate suitable policies and strategies to take the CSR and Sustainability agenda of the company forward in the desired direction.

CPSEs should integrate and align their CSR and Sustainability policies and activities with their business goals, plans and strategies to represent the true good governance.

CONCLUSION

The Companies Act, 2013 is applicable to all companies registered under the Act. 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. However, the private sector and foreign banks being a company registered under the Companies Act, 2013 are governed by its provisions in addition to other applicable laws.

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.

The specific sector companies like Banks, Insurance & PSUs have different norms prescribed by the respective regulator to govern the corporate practices. Ideally, there is a need to standardise these practices and harmonise the statutory provisions to provide a single code of corporate governance which can be adopted by all the sectors.

LESSON ROUND-UP

- Banks are different from other corporates in many important respects, and that makes corporate governance of banks not only different but also more critical. By the very nature of their business, banks are highly leveraged.
- Banks can be classified as Scheduled Bank and Unscheduled Bank. Scheduled Banks expressed as Scheduled Commercial Banks (SCBs) which can be further grouped as State Banks Group and other Nationalized Banks, Foreign Banks, Regional Rural Banks and other Scheduled Commercial Banks.
- The Reserve Bank of India, the central bank of the country, is the primary regulator of banks. The Banking Regulation Act, 1949 applies to all banks. The provisions of this Act shall be in addition to, and not, unless expressly provided, in derogation of the Companies Act, 2013 and any other law for the time being in force. Companies Act, 2013 is applicable to all private sector banks registered under the Companies Act, 2013.
- 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.
- IRDA has advised insurers to mandatory establish Audit; Investment; Risk Management; Policyholder Protection; and Asset Liability Management (in case of life insurers) Committees. Establishment of the other Committees is left to the option of the insurer.
- Section 34A of the Insurance Act, 1938 requires prior approval of the IRDA for appointment, re-appointment or termination of the Chief Executive Officer and the Whole Time Directors.
- The IRDA guidelines provide for joint audit of each insurance company by two statutory Auditors.

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
- Global Corporate Governance Forum
- 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

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. So far ICSI has issued 10 Secretarial Standards.

- **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 stakehold-ers.

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) in partnership 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.

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 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.

Principles of Corporate Governance – OECD

- (a) They call on governments to have in place an effective institutional and legal framework to support good corporate governance practices.
- (b) They call for a corporate governance framework that protects and facilitates the exercise of shareholders' rights.
- (c) They also strongly support the equal treatment of all shareholders, including minority and foreign shareholders.
- (d) They recognise the importance of the role of stakeholders in corporate governance.
- (e) They look at the importance of timely, accurate and transparent disclosure mechanisms
- (f) They deal with board structures, responsibilities and procedures.

The OECD Principles are one of the 12 key standards for international financial stability 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 preamble to the OECD Principles states that they “*are evolutionary in nature and should be reviewed in light of significant changes in circumstances*”. It also recognises that, “*To remain competitive in a changing world, corporations must innovate and adapt their corporate governance practices so that they can meet new demands and grasp new opportunities*”.

Regional initiatives

OECD corporate governance co-operation with non-OECD economies is organised around regional roundtables and country programmes which provide key forums for dialogue and the sharing of best policy practices.

Asian Context

Established in 1999, the **OECD-Asian Roundtable on Corporate Governance (ARCG)** serves as a regional forum for exchanging experiences and advancing the reform agenda on corporate governance while promoting awareness and use of the OECD Principles of Corporate Governance. It brings together policy makers, practitioners and experts on corporate governance from the Asian region, OECD countries and relevant international organisations.

D. GLOBAL CORPORATE GOVERNANCE FORUM (GCGF)

The Global Corporate Governance Forum (the Forum) was founded in 1999 by the World Bank and the Organisation

for Economic Co-operation and Development (OECD) following the financial crises in Asia and Russia in the latter part of the 1990's. It was established to promote initiatives to raise corporate governance standards and practices in developing countries and emerging markets, using the OECD Principles of Corporate Governance as the basis for its work. The Forum's work program was launched in 2002 in Monterrey, Mexico at the Financing for Development meetings organized by the United Nations. It is a multi-donor trust funded IFC facility hosted by the joint IFC-WB Corporate Governance Department, in Washington D.C. The Forum is also funded by the governments of Canada, France, Luxembourg, Norway, Sweden, and Switzerland.

The Forum promotes sustainable economic growth and poverty reduction within the framework of agreed international development targets. The Forum focuses on practical, targeted corporate governance initiatives at the local, regional and global level.

The Forum contributes to the efforts of the international community to promote the private sector as an engine of growth, reduce the vulnerability of developing and transition economies to financial crises, and provide incentives for corporations to invest and perform efficiently, in a socially responsible manner. It fosters cooperation with various corporate governance programs and plays a coordinating role among donors, founders and other relevant institutions. The Forum seeks to address the corporate governance weaknesses of middle-income and low-income countries in the context of broader national or regional economic reform programs. The Forum has an extensive work program to support corporate governance reform in developing countries. The focus of the work program is based on four core pillars as defined in its charter.

The work program of the Forum is executed, managed, and implemented by the Secretariat, which is the executive arm of the Forum. The Secretariat is also responsible for disbursing funding in accordance with the procedures and criteria agreed by the Steering Committee of Donors and Founders.

The Global Corporate Governance Forum's mandate is to promote global, regional and local initiatives that improve corporate governance policy standards and practices in developing countries on the following four areas:

Forum's four Focus Areas – GCGF
<ul style="list-style-type: none"> (a) raising awareness and building consensus for implementation of reform through meetings, briefings, policy papers, and conferences; (b) sponsoring research relevant to the needs of developing countries to underpin reform efforts by sound analysis through sponsoring papers and building sustainable networks for academics in developing countries; (c) disseminating best practice materials and publications and guidelines developed with leading global specialists and practitioners; and (d) supporting institution and capacity building and providing technical assistance to ensure implementation at the field level through training programs, toolkits and other direct assistance.

The Forum is dedicated to advancing corporate governance in emerging-market and developing countries by creating and disseminating practical tools that provide expert guidance on corporate governance and its implementation.

Programs for implementation of its Initiatives – GCGF	
Corporate Governance Board Leadership Training	With the assistance of Institutes of Directors and other organizations, the Forum is training trainers to help board directors become “change agents” within their organizations for the adoption of corporate governance best practices.
Corporate Governance Codes and Scorecards	The Forum has supported scores of countries in drafting, implementing, and monitoring corporate governance codes of best practice and scorecards.
Media Training Program on Corporate Governance Reporting	In partnership with Thomson Reuters Foundation and Agence France Presse, the Forum trains financial journalists to improve their coverage of corporate governance. By broadening awareness, the journalists help promote corporate governance best practices.
Resolving Corporate Governance Disputes	To help companies manage corporate governance disputes more effectively, the Forum, in cooperation with IFC Advisory Services, promotes the use of alternative dispute resolution processes and techniques.
Research Network	The Forum supports a network of leading academics who generate high-priority research on corporate governance issues relevant to emerging markets and developing countries.

E. 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
<p>(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;</p> <p>(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;</p> <p>(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</p> <p>(d) to advance the interests of members of the Institute, and to provide facilities, services and benefits for them.</p>

The day-to-day running of the Institute is managed by the Executive Director, headed by the Director General.

F. 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

Principles for Corporate Governance in the Commonwealth

The guidelines which follow 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.

G. 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:

- to provide an investor-led network for the exchange of views and information about corporate governance issues internationally;
- to examine corporate governance principles and practices; and
- to develop and encourage adherence to corporate governance standards and guidelines;
- 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 functions of the ICGN Secretariat were first undertaken by the Association of British Insurers (ABI) and then in 2000, by the Institute of Chartered Secretaries and Administrators (ICSA) in London.

Global Corporate Governance Principles: Revised (2009)

The Principles aim to assert standards of corporate governance to which the ICGN believes that all companies should aspire. The Principles are intended to be of general application around the world, irrespective of legislative background or listing rules. These Principles are the ICGN's overarching set of Principles.

H. 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.

I. 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 help 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.

J. 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.

K. CORPORATE SECRETARIES INTERNATIONAL ASSOCIATION (CSIA)

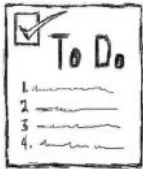
CSIA, a Geneva-registered body, which was established on March 2010 is an international organization whose members comprise national bodies of professionals at the frontline of governance. It is dedicated to promoting the values and practices of governance professionals in order to create, foster or enhance the environment in which business can be conducted in a fair, profitable and sustainable manner. CSIA issued Twenty Practical Steps to Better Corporate Governance

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

278 PP-EGAS

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



Remember to do:

Students must know about international developments in Corporate Governance. Hence go through all the links of international forums

- <http://www.nfcgindia.org>
- www.oecd.org/daf/corporateaffairs/principles/text
- <http://www.gcgf.org>
- <http://www.iod.com>
- <http://www.icgn.org/>
- www.ecgi.org/
- <http://www.conference-board.org/>
- <http://www.acga-asia.org/>
- www.csiaorg.com
- http://www.ecgi.org/codes/code.php?code_id=24

LESSON 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.
- Global Corporate Governance Forum (the Forum) was founded in 2001 by the World Bank and the Organisation for Economic Co-operation and Development (OECD) following the financial crises in Asia and Russia in the latter part of the 1990’s.
- 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) Global Corporate Governance Forum

Lesson 12

Legislative Framework of Corporate Governance - An International

LESSON OUTLINE

- Introduction
- Corporate Governance in Australia
- Australian Securities Exchange - Listing Rules
- Corporate Governance Principles and Recommendations by the ASX Corporate Governance Council
- Corporate Governance in Singapore
- Singapore Code of Corporate Governance (2012)
- Corporate Governance in South Africa
- King Code of Governance for South Africa (KING-III)
- Corporate Governance in UK
- U K Corporate Governance Code - 2012
- Malaysian Corporate Governance Code, 2012
- Global Contemporary Developments in Corporate Governance
- Corporate Governance Codes - Globally
- LESSON ROUND-UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

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. The Study Lesson briefly covers the governance framework in:

- Australia - Corporate Governance Principles and Recommendations by the ASX Corporate Governance Council (2014)
- Singapore - Code of Corporate Governance (2012)
- South Africa- King Code of Governance for South Africa 2009
- United Kingdom - The Corporate Governance Code -2012
- Malaysian Corporate Governance Code 2012
- Global Developments in Corporate Governance and latest codes of Corporate Governance

“The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources.”

-Sir Adrian Cadbury, UK, Commission Report

INTRODUCTION

International bodies, governments, financial institutions, public and private sector bodies 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.

Much of the debate surrounding corporate governance relate to issues such as the separation of the role of the chairman and the chief executive officer, the establishment of audit, remuneration and nomination committees and the increased number of independent non-executive directors on the board.

In this Study Lesson we will be looking at the Corporate Governance regimes relating to these issues in the Australia, Singapore, South Africa and United Kingdom.

AUSTRALIA

Australia's corporate governance framework contains a range of measures that promote accountability of management and transparency of financial and other information. On the regulatory framework of corporate governance, the Australian government has undertaken a set of reforms to improve disclosure norms of financial information and to update accounting rules. In the matter of corporate governance in Australia, the recommendation of Shann Turnbull, a very well-known Australian expert in corporate governance deserves mention. He has recommended that there should be a 'dual board structure' along with a 'corporate senate' to oversee the regular board functioning (senate means a council). The corporate senate will determine accounting policies, direct audit activities, arbitrate on board conflicts, advise AGM on directors benefits. The senate will also nominate directors on the Board and will act as trustees for any Employees Stock Option Scheme (ESOP). The corporate senate will have maximum of 3 (three) members who will be elected on the basis of 'one vote per shareholder' instead of 'one vote per share' principle. The corporate senate should have no proactive power of any kind. However, it will have the 'veto' power over any activity in which the board has a conflict of interests, and even that can be overridden by a vote of 75% of the shares.

According to the 1998 International Survey of Institutional Investors carried out by Russell Reynolds Associates, the institutions have set high standards of corporate governance in Australia using the code of corporate practices and conduct as their basic model. As Australian companies begin to have global dimensions the pressure for good governance will increase in the coming days.

Accountability

In the area of accountability, there are certain minimum obligations and responsibilities directors must fulfil including duties to:

- act in good faith;
- act in the best interests of the company;
- exercise their powers with appropriate care and diligence that is reasonable in all of the circumstances;
- not to make inappropriate use of inside information;
- not misuse their position for their own or a third party's possible advantage (or to the possible detriment of the company);
- avoid inappropriate related party transactions; and
- avoid insolvent trading.

Transparency and Disclosure

The principal objective of Australia's corporate regulatory framework is to enhance disclosure and ensure transparency of corporate information as a means of promoting proper conduct of directors and senior management.

Among the areas covered by the Corporations Act are:

- the formulation of Australian Accounting Standards to ensure company financial statements can be relied on to by all stakeholders;
- timely disclosure to the market of events that may affect the price of the company's shares;
- information about shareholdings and beneficial ownership of shares;
- the entitlement of shareholders to information about the timing of general meetings and their purpose;
- the entitlement of shareholders to ask questions about or comment on the company's management;
- the provision of information to shareholders in relation to related party transactions;
- notification to ASIC of information relating to directors, and company officers including CEO's and company secretaries;
- the maintenance by companies of registers of members, option holders and debenture holders; and
- exposure of director's remuneration and the number of meetings directors have attended.

The Australian Securities Exchange

The Australian Securities Exchange through its listing rules, regulates the behaviour of ASX listed companies. In addition to the listing rules, which are mandatory, the ASX has a set of guidance notes to assist listed companies to comply with both the spirit and letter of the rules.

The ASX Corporate Governance Council issued Corporate Governance Principles and Recommendations

The ASX Corporate Governance Council issued Corporate Governance Principles and Recommendations in 2003. These were revised in 2007 and came into effect from January 1, 2008. It has been further revised in 2010. Following a comprehensive review in 2012-13, the 21 members of the ASX Corporate Governance Council ("Council") agreed that it was an appropriate time to issue a third edition of the Principles and Recommendations. The changes in the third edition issued on 27th March, 2014, reflect global developments in corporate governance since the second edition was published. The opportunity has also been taken to simplify the structure of the Principles and Recommendations and to afford greater flexibility to listed entities in terms of where they make their governance disclosures.

The ASX Corporate Governance Council's Recommendations articulates eight core principles. Each Principle is explained in detail, with commentary about implementation in the form of Recommendations. The Principles and Recommendations apply to all ASX listed entities, regardless of the legal form they take, whether they are established in Australia or elsewhere, and whether they are internally or externally managed.

The Principles and Recommendations are structured around, and seek to promote, 8 central principles:

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.
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.

3. Act ethically and responsibly: A listed entity should act ethically and responsibly.
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.
5. Make timely and balanced disclosure: A listed entity should make timely and balanced disclosure of all matters concerning it that a reasonable person would expect to have a material effect on the price or value of its securities.
6. Respect the rights of security holders: A listed entity should respect the rights of its security holders by providing them with appropriate information and facilities to allow them to exercise those rights effectively.
7. Recognise and manage risk: A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework.
8. Remunerate fairly and responsibly: A listed entity should pay director remuneration sufficient to attract and retain high quality directors and design its executive remuneration to attract, retain and motivate high quality senior executives and to align their interests with the creation of value for security holders.

These are further explained as under:

Principle 1: Lay solid foundations for management and oversight

- Companies should establish the functions reserved to the board and those delegated to senior executives and disclose those functions.
- The performance of senior executives should be reviewed regularly against appropriate measures. Companies should disclose the process for evaluating the performance of senior executives.
- Directors should clearly understand corporate expectations of them. To that end, formal letters upon appointment of directors should be issued setting out the key terms and conditions to that appointment.

Principle 2: Structure the board to add value

- Companies should have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties
- Majority of the board should be independent directors including its Chairman. 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.
- When determining the independent status of a director the board should consider whether the director:
 - is a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company.
 - is employed, or has previously been employed in an executive capacity by the company or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the board
 - has within the last three years been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided
 - is a material supplier or customer of the company or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer
 - has a material contractual relationship with the company or another group member other than as a director.

The board should regularly assess whether each non-executive director is independent. Each non-executive director should provide to the board all information that may be relevant to this assessment.

- If the Chairman of the board is not an independent director, it may be beneficial to consider the appointment of a lead independent director.
- The roles of chair and chief executive officer should not be exercised by the same individual.
- The board should establish a **nomination committee** with the following:
 - At least three members with majority of independent directors
 - Independent director to chair the meeting
- Responsibilities of the committee should include recommendations to the board about:
 - the necessary and desirable competencies of directors
 - review of board succession plans
 - the development of a process for the evaluation of the performance of the board, its committees and directors
 - the appointment and re-election of directors.
- Companies should disclose the process for evaluating the performance of the board, its committees and individual directors.

The board and company secretary

- The company secretary plays an important role in supporting the effectiveness of the board by monitoring that board policy and procedures are followed, and coordinating the timely completion and despatch of board agenda and briefing material.
- It is important that all directors have access to the company secretary.
- The appointment and removal of the company secretary should be a matter for decision by the board as a whole.
- The company secretary should be accountable to the board, through the chair, on all governance matters.

Principle 3: Act ethically and responsibly

Companies should:

- clarify the standards of ethical behavior required of the board, senior executives and all employees and encourage the observance of those standards
- comply with their legal obligations and have regard to the reasonable expectations of their stakeholders
- publish their policy concerning diversity, or a summary of that policy, and disclose annually their measurable objectives for achieving gender diversity, their progress toward achieving those objectives and the proportion of women in the whole organisation, in senior management positions and on the board .
- establish a code of conduct and disclose the code or a summary of the code
- companies should disclose in each annual report the measurable objectives for achieving gender diversity set by the board in accordance with the diversity policy and progress towards achieving them.

Principle 4: Corporate Reporting

- Companies should have a structure to independently verify and safeguard the integrity of their financial reporting.

- The board should establish an audit committee with the following structure:
- At least three members and consists only of non-executive directors with a majority of independent Directors
- Chaired by an independent chairman, who is not chairman of the board
- The audit committee should review the integrity of the corporate reporting and oversee the independence of the external auditors.
- The audit committee should have a formal charter and it should report to the board on all matters relevant to the committee's role and responsibilities.

Principle 5: Make timely and balanced disclosure

- Companies should promote timely and balanced disclosure of all material matters concerning the company.
- Companies should establish written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose those policies or a summary of those policies.
- Companies should include commentary on their financial results to enhance the clarity and balance of reporting. This commentary should include information needed by an investor to make an informed assessment of the entity's activities and results.

Principle 6: Respect the rights of security holders

- Companies should respect the rights of security holders and facilitate the effective exercise of those rights.
- Companies should design a communications policy for promoting effective communication with security holders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.
- All companies should have a website and are encouraged to communicate with security holders via electronic methods. If a company does not have a website it must make relevant information available to security holders by other means, for example, a company may provide the information on request by email, facsimile or post.
- The company should describe in its Annual Report, how it communicate with its security holders publicly, ideally by posting the information on the company's website in a clearly marked corporate governance section.

Principle 7: Recognise and manage risk

- Companies should establish a sound system of risk oversight and management and internal control.
- Companies should establish policies for the oversight and management and management of material business risks and disclose a summary of those policies.
- The board should require management to design and implement the risk management and internal control system to manage the company's material business risks and report to it on whether those risks are being managed effectively. The board should disclose that management has reported to it as to the effectiveness of the company's management of its material business risks.
- A board committee is an efficient mechanism for focusing the company on appropriate risk oversight, risk management and internal control. Ultimate responsibility for risk oversight and risk management rests with the full board, whether or not a separate risk management committee exists.
- The company should made publicly, ideally by posting it to the Company's Website a summary of the company's policies on risk oversight and management of material business risks.

Principle 8: Remunerate fairly and responsibly

- Companies should ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to performance is clear.
- A board remuneration committee is an efficient mechanism for focusing the company on appropriate remuneration policies. The board should establish a remuneration committee with the following structure:
 - consists of a majority of independent directors
 - is chaired by an independent director
 - has at least three members.
- The remuneration committee should have a charter that clearly sets out its role and responsibilities, composition, structure and membership requirements and the procedures for inviting non-committee members to attend meetings.
- The company should design its remuneration policy in such a way that it motivates senior executives to pursue the long-term growth and success of the company and demonstrates a clear relationship between senior executives performance and remuneration.
- Companies should clearly distinguish the structure of non-executive directors’ remuneration from that of executive directors and senior executives.

Companies are expected to provide explanation of any departures from aforesaid Principles and Recommendations, which should be included in the corporate governance statement in the annual report.

The Recommendations are not prescriptions, they are guidelines, designed to bring out effective governance structure. The approach is similar to the UK combined code – i.e. ‘Comply or Explain’. In Australia it is called “if not, why not approach”. If a company considers that a recommendation is inappropriate to a particular circumstance, it has the flexibility not to adopt it and explain why it has not adopted.

SINGAPORE

Corporate Governance in Singapore

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 (the Code), 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.

The Code of Corporate Governance was first issued by the Corporate Governance Committee (“CGC”) on 21 March 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. A revised Code was issued on 14 July, 2005.

The Code of Corporate Governance came under the purview of Monetary Authority of Singapore (MAS) and SGX with effect from 1 September 2007. The Corporate Governance Council (“Council”) conducted a comprehensive review of the Code, and submitted its recommendations to MAS on 22nd November 2011. MAS issued a revised Code of Corporate Governance on 2nd May, 2012. The 2012 Code of Corporate Governance supersedes and replaces the Code that was issued in July 2005. The Code will take effect in respect of Annual Reports relating to financial years commencing from 1st November 2012.

Following Principles are prescribed under the Code:

1. Board of Directors

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.

2. Board Composition and Guidance

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.

Normally, at least one-third of the Board should consist of Independent Directors. However, the independent directors should make up at least half of the Board where:

- (a) the Chairman and Chief Executive Officer (or equivalent) is the same person;
- (b) the Chairman and the CEO are immediate family members;
- (c) the Chairman is part of the management team; or
- (d) the Chairman is not an independent director.

In the aforesaid situation, every company should appoint an independent director to be the lead independent director. Led by the lead independent director, the independent directors should meet periodically without the presence of the other directors, and the lead independent director should provide feedback to the Chairman after such meetings.

An "independent" director is one who has no relationship with the company, its related corporations, its 10% shareholders 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.

The Board should identify in the company's Annual Report each director it considers to be independent. The Board should determine, taking into account the views of the Nominating Committee, whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement.

The independence of any director who has served on the Board beyond nine years from the date of his first appointment should be subject to particularly rigorous review. The Board should also explain why any such director should be considered independent.

The Board and its board committees should comprise directors who as a group provide an appropriate balance and diversity of skills, experience, gender and knowledge of the company.

3. Division of Responsibilities between Chairman and CEO

There should be a clear division of responsibilities between the leadership of the Board and the executives responsible for managing the company's business to ensure an appropriate balance of power, increased accountability and greater capacity of the Board for independent decision making. No one individual should represent a considerable concentration of power.

- (a) the Chairman and the CEO is the same person;
- (b) the Chairman and the CEO are immediate family members;

- (c) the Chairman is part of the management team; or
- (d) the Chairman is not an independent director.

4. Board Membership

There should be a formal and transparent process for the appointment and re-appointment of directors to the Board. The Board should establish a Nomination Committee (NC) to make recommendations to the Board on all board appointments, with written terms of reference which clearly set out its authority and duties. The NC should comprise at least three directors, the majority of whom, including the Chairman, should be independent. The lead independent director, if any, should be a member of the NC.

The Nomination Committee should make recommendations to the Board on relevant matters relating to:

- (a) the review of board succession plans for directors, in particular, the Chairman and for the CEO;
- (b) the development of a process for evaluation of the performance of the Board, its board committees and directors;
- (c) the review of training and professional development programs for the Board; and
- (d) the appointment and re-appointment of directors (including alternate directors, if applicable).

5. Board Performance

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. The Board should state in the company's Annual Report how the assessment of the Board, its board committees and each director has been conducted.

Individual evaluation should aim to assess whether each director continues to contribute effectively and demonstrate commitment to the role (including commitment of time for meetings of the Board and board committees, and any other duties). The Chairman should act on the results of the performance evaluation, and, in consultation with the Nomination Committee, propose, where appropriate, new members to be appointed to the Board or seek the resignation of directors.

6. Access to Information

In order to fulfill 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.

Directors should have separate and independent access to the company secretary. The role of the company secretary should be clearly defined and should include responsibility for ensuring that board procedures are followed and that applicable rules and regulations are complied with. Under the direction of the Chairman, the company secretary's responsibilities include ensuring good information flows within the Board and its board committees and between Management and non-executive directors, advising the Board on all governance matters, as well as facilitating orientation and assisting with professional development as required. The company secretary should attend all board meetings. The appointment and the removal of the company secretary should be a matter for the Board as a whole.

7. Remuneration Matters

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.

The Board should establish a Remuneration Committee (RC) with written terms of reference which clearly set out its authority and duties. The RC should comprise at least three directors, the majority of whom, including the Chairman, should be independent. All the committee members should be non-executive directors. The committee should review and recommend to the Board a general framework of remuneration for the Board and key management personnel. The Committee's recommendations should be submitted for endorsement by the entire Board.

8. Level and Mix of Remuneration

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.

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 and Audit

The Board should present a balanced and understandable assessment of the company's performance, position and prospects. The Board should take adequate steps to ensure compliance with legislative and regulatory requirements, including requirements under the listing rules of the securities exchange, for instance, by establishing written policies where appropriate.

The Board should establish an Audit Committee ("AC") with written terms of reference which clearly set out its authority and duties.

The AC should comprise at least three directors, the majority of whom, including the Chairman, should be independent. All of the members of the AC should be non-executive directors.

The Board should ensure that the members of the AC are appropriately qualified to discharge their responsibilities. At least two members, including the Chairman, should have recent and relevant accounting or related financial management expertise or experience, as the Board interprets such qualification in its business judgment. The AC should meet with the external auditors and internal auditors, in each case without the presence of Management, at least annually.

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.

The Board may establish a separate board risk committee or otherwise assess appropriate means to assist it in carrying out its responsibility of overseeing the company's risk management framework and policies.

12. Internal Audit

The company should establish an effective internal audit function that is adequately resourced and independent of the activities it audits. The Internal Auditor's primary line of reporting should be to the Audit Committee Chairman although the Internal Auditor would also report administratively to the CEO.

The Audit Committee should, at least annually, review the adequacy and effectiveness of the internal audit function.

13. Shareholder Rights & Responsibilities and Communication with Shareholders

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.

Companies should actively engage their shareholders and put in place an investor relations policy to promote regular, effective and fair communication with shareholders. 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.

Companies should put all resolutions to vote by poll and make an announcement of the detailed results showing the number of votes cast for and against each resolution and the respective percentages. Companies are encouraged to employ electronic polling.

(For details on Corporate Governance Code, student may refer the website: <http://www.mas.gov.sg/>)

SOUTH AFRICA

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. Besides the legal enactments, there are corporate governance codes which laid the foundation for corporate governance framework in South Africa.

The release of King III report on 1 September 2009 represents a significant milestone in the evolution of corporate governance in South Africa and brings with it significant opportunities for organisations that embrace its principles.

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.

It is important to understand that 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;
- Sustainability; and
- Corporate Citizenship.

The King III Report has 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

Following are some highlights of King Code of Governance for South Africa 2009:

1. Ethical leadership and corporate citizenship

- The board should provide effective leadership based on an ethical foundation
- The board should ensure that the company is seen to be a responsible corporate citizen
- The board should ensure that the company's ethics are managed effectively

2. Board of Directors

Role and function of the board

- The board should act as the focal point for and custodian of corporate governance
- The board should appreciate that strategy, risk, performance and sustainability are inseparable
- The board should ensure that the company has an effective and independent audit committee
- 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.
- A lead independent director should be appointed in the case where an executive chairman is appointed or where the chairman is not independent or conflicted.
- The board should appoint the chief executive officer and establish a framework for the delegation of authority

Board Composition

- The board should comprise a balance of power, with a majority of non-executive directors. The majority of non-executive directors should be independent.
- Any independent non-executive directors serving more than 9 years should be subjected to a rigorous review of his independence and performance by the board
- Every board should have a minimum of two executive directors of which one should be the CEO and the other the director responsible for finance.
- At least one third of the non-executive directors should rotate every year.
- The board, through its nomination committee, should recommend the eligibility of prospective directors.

Board appointment process

- Directors should be appointed through a formal process
- A nomination committee should assist with the process of identifying suitable members of the board
- The appointment of non-executive directors should be formalised through a letter of appointment.

Director development

- The induction and ongoing training and development of directors should be conducted through formal processes
- The board should ensure that a formal induction programme is established for new directors and inexperienced directors are developed through mentorship programmes;

Company Secretary

- The board should be assisted by a competent, suitably qualified and experienced company secretary
- The board should appoint and remove the company secretary
- The company secretary should:
 - have an arms-length relationship with the board;
 - not be a director of the company;
 - assist the nominations committee with the appointment of directors;

- assist with the director induction and training programmes;
- provide guidance to the board on the duties of the directors and good governance;
- ensure board and committee charters are kept up to date;
- prepare and circulate board papers;
- elicit responses, input, feedback for board and board committee meetings;
- assist in drafting yearly work plans;
- ensure preparation and circulation of minutes of board and committee meetings; and
- assist with the evaluation of the board, committees and individual directors.

Performance Assessment

- The evaluation of the board, its committees and the individual directors should be performed every year
- The results of performance evaluations should identify training needs for directors.
- An overview of the appraisal process, results and action plans should be disclosed in the integrated report.
- The nomination for the re-appointment of a director should only occur after the evaluation of performance and attendance of the director.

Board Committees

- The board should delegate certain functions to well-structured committees but without abdicating its own responsibilities
- Public and state-owned companies must appoint an audit committee.
- All other companies should establish an audit committee and define its composition, purpose and duties in the memorandum of incorporation.
- Companies should establish risk, nomination and remuneration committees.
- Committees, other than the risk committee, should comprise a majority of nonexecutive directors of which the majority should be independent.

Remuneration of directors and senior executives

- Companies should remunerate directors and executives fairly and responsibly. Companies should adopt remuneration policies aligned with the strategy of the company and linked to individual performance. The remuneration committee should assist the board in setting and administering remuneration policies.
- Companies should disclose the remuneration of each individual director and certain senior executives
- Shareholders should approve the company's remuneration policy

3. Audit committee

- The board should ensure that the company has an effective and independent audit committee
- Audit committee members should be suitably skilled and experienced independent non-executive directors
- All members of the audit committee should be independent non-executive directors.
- The audit committee should consist of at least three members.
- The chairman of the board should not be the chairman or member of the audit committee. The audit committee should be chaired by an independent non-executive director.

- The audit committee should oversee integrated reporting
- The audit committee should satisfy itself of the expertise, resources and experience of the company's finance function
- The audit committee should be responsible for overseeing of internal audit
- The audit committee is responsible for recommending the appointment of the external auditor and overseeing the external audit process
- The audit committee should report to the board and shareholders on how it has discharged its duties

4. Risk Governance

- The board should be responsible for the governance of risk
- The risk committee or audit committee should assist the board in carrying out its risk responsibilities
- The board should ensure continual risk monitoring by management
- The board should receive assurance from management regarding the effectiveness of the risk management process
- The board should ensure that there are processes in place enabling complete, timely, relevant, accurate and accessible risk disclosure to stakeholders.

5. Information Technology (IT) Governance

- The board should be responsible for information technology (IT) governance
- The board should ensure that an IT charter and policies are established and implemented.
- The board should receive independent assurance on the effectiveness of the IT internal controls.
- The board should ensure that there is a process in place to identify and exploit opportunities to improve the performance and sustainability of the company through the use of IT.
- The board should delegate to management the responsibility for the implementation of an IT governance framework.

6. Compliance with laws, rules, codes and standards

- The board should ensure that the company complies with applicable laws and considers adherence to nonbinding rules, codes and standards
- Compliance risk should form an integral part of the company's risk management process

7. Internal audit

- Internal audit should follow a risk based approach to its plan
- Internal audit should provide a written assessment of the effectiveness of the company's system of internal controls and risk management
- The audit committee should be responsible for overseeing internal audit

8. Stakeholder Relationships

- The board should delegate to management to proactively deal with stakeholder relationships
- The board should strive to achieve the appropriate balance between its various stakeholder groupings, in the best interests of the company
- Companies should ensure the equitable treatment of shareholders
- The board should ensure that disputes are resolved as effectively, efficiently and expeditiously as possible

9. Integrated reporting and disclosure

- The board should ensure the integrity of the company's integrated report.
- Sustainability reporting and disclosure should be integrated with the company's financial reporting
- Sustainability reporting and disclosure should be independently assured
- The audit committee should assist the board by reviewing the integrated report to ensure that the information contained in it is reliable and that it does not contradict the financial aspects of the report
- The audit committee should oversee the provision of assurance over sustainability issues.

UNITED KINGDOM

Corporate Governance in the United Kingdom (UK)

The “comply or explain” approach is the trademark of corporate governance in the UK. It has been in operation since the Code's beginnings and is the foundation of the Code's flexibility. It is strongly supported by both companies and shareholders and has been widely admired and imitated internationally.

UK combined Code 2008, has set standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders. Significant decline in economic conditions led to revision of the Combined Code by Financial Reporting Council during 2009 by Sir David Walker. It was announced that the Code would be known as the UK Corporate Governance Code 2010, in order to make the Code's status as the UK's recognised corporate governance standard known to foreign investors, and to foreign companies listed in the UK.

The code was further revised after the deliberation and stakeholder's consultation in 2011 and the revised combined code 2012 version was issued in September, 2012.

The UK Corporate Governance Code, 2012 sets out the standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders. Listed Companies are required to report on how they have applied the main principle of the code, and either to confirm that they have complied with the code's provisions or where they not- to provide an explanation. The new Code 2012 applies to accounting periods beginning on or after 1st October 2012.

The UK Corporate Governance Code is the re-fragmentation of the earlier UK combined Code on Corporate Governance with several structural changes including new provisions relating to board evaluation and annual elections. It is subject to the existing 'comply or explain' approach. Following are the few relevant developments in the Code.

Board Composition

The board should include an appropriate combination of executive and non-executive directors (and, in particular,

independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.

The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:

- has been an employee of the company or group within the last five years;
- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;
- has close family ties with any of the company's advisers, directors or senior employees;
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder; or
- has served on the board for more than nine years from the date of their first election.

Except for smaller companies (a smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year), at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors.

Role of the Board

UK Corporate Governance Code clearly provides that every company shall be headed by an effective Board which shall collectively be responsible for the long term success 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 should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The code provides that 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.

The Code encourages nomination committees explicitly to include the board's gender mix in the factors that are taken into account when considering the need for new appointments. The principle now reads: "The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender".

Chairman

In addition to separation of roles between the chairman and chief executive officer the chairman is also held responsible for leadership of the board and ensuring its effectiveness on all aspects of its role. The chairman should also promote a culture of openness and debate by facilitating the effective contribution of non executive directors in particular and ensuring constructive relations between executive and non-executive directors. The principle refers to the chairman's responsibilities for ensuring a culture of openness and debate, and that adequate time is available for discussion. The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders. A new provision has been added stating that the chairman should regularly review and agree with each director their training and development needs.

Senior Independent Directors

The board should appoint one of the independent non-executive directors to be the senior independent director to provide a representing board for the chairman and to serve as an intermediary for the other directors when necessary. 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. The senior independent director is also expected to attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders.

Performance Evaluation of Directors

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board. The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted. Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. A statement should be made available of whether an external facilitator has any other connection with the company. 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.

Election of Directors

The code provides that all directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. It provides that the 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. Non executive directors who have served longer than nine years should be subject to annual re-election. 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.

Accountability and Risk Management

The code provides that the board should present a fair, balanced and understandable assessment of the company's position and prospects. The board's responsibility 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. An explanation shall be added to the annual report stating the company's strategy for generating long term value (the business model) that would enhance the ability of investors and other users of report to assess the disclosures required under the Business Review.

The code has clearly held the board responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

Remuneration

The performance-related elements of executive directors' remuneration should be stretching and designed to promote the long-term success of the company. Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose.

Apart from other things, remuneration for non-executive directors should reflect the time commitment and

responsibilities of their role. Remuneration for non executive directors should not include share options or other performance related elements. Payouts under incentive schemes should be subject to non-financial performance criteria where appropriate and compatible with the company's risk policies and systems, and that companies should consider provisions that enable them to reclaim variable components in cases of mis-statement or misconduct. The code provides that for each resolution, where a vote has been taken on a show of hands, the company should ensure that the information relating to results is disclosed in meeting and also on the website of the company.

MALASIYA

Malaysian Corporate Governance Code, 2012

Malaysian Government issued the Malaysian Code on Corporate Governance (Code) in the year 2000 to strengthen corporate governance framework in Malaysia. Subsequently, the Code was revised and securities and companies laws were amended. The Audit Oversight Board was established to provide independent oversight over external auditors of companies. The Securities Industry Dispute Resolution Center was established to facilitate the resolution of small claims by investors. Statutory derivative action was introduced to encourage private enforcement action by shareholders.

The Securities Commission Malaysia's (SCM) five-year Corporate Governance Blueprint launched on July 8, 2011, providing for action plan to raise the standards of corporate governance in Malaysia by strengthening self and market discipline and promoting greater internalisation of the culture of good governance.

The Malaysian Code on Corporate Governance 2012 effective from December 31, 2012 is the first deliverable of the CG Blueprint and supercedes the Malaysian Code on Corporate Governance. It sets out broad principles and specific recommendations on structures and processes which companies should adopt in making good corporate governance an integral part of their business dealings and culture. The code focuses on clarifying the role of the board in providing leadership, enhancing board effectiveness through strengthening its composition and reinforcing its independence. It also encourages companies to put in place corporate disclosure policies that embody principles of good disclosure.

Companies are encouraged to make public their commitment to respecting shareholder rights. The Malaysian Code on Corporate Governance, 2012 consists of eight principles encapsulating broad concepts underpinning good corporate governance that companies should apply when implementing the recommendations.

The recommendations are standards that companies are expected to adopt as part of their governance structure and processes. Listed companies should explain in their annual reports how they have complied with the recommendations. The companies are allowed to determine the best approach to adopting the principles. Where there is non-observance of a recommendation, companies should explain the reasons. Each recommendation is followed by a commentary which seeks to assist companies in understanding the recommendation. It also provides some guidance to companies in implementing the recommendation. Although some of the commentaries provide examples and suggestions, these should not be taken to be exhaustive.

The Principles and Recommendation as enumerated under the Malaysian Code on Corporate Governance 2012 are as under:

PRINCIPLE 1: ESTABLISH CLEAR ROLES AND RESPONSIBILITIES

The responsibilities of the board, which should be set out in a board charter, include management oversight, setting strategic direction premised on sustainability and promoting ethical conduct in business dealings.

Recommendation 1.1 :The board should establish clear functions reserved for the board and those delegated to management.

Recommendation 1.2 : The board should establish clear roles and responsibilities in discharging its fiduciary and leadership functions.

Recommendation 1.3 : The board should formalise ethical standards through a code of conduct and ensure its compliance.

Recommendation 1.4 : The board should ensure that the company's strategies promote sustainability.

Recommendation 1.5 : The board should have procedures to allow its members access to information and advice.

Recommendation 1.6 : The board should ensure it is supported by a suitably qualified and competent company secretary.

Recommendation 1.7 : The board should formalise, periodically review and make public its board charter.

PRINCIPLE 2: STRENGTHEN COMPOSITION

The board should have transparent policies and procedures that will assist in the selection of board members. The board should comprise members who bring value to board deliberations.

Recommendation 2.1 : The board should establish a Nominating Committee which should comprise exclusively of non-executive directors, a majority of whom must be independent.

Recommendation 2.2 : The Nominating Committee should develop, maintain and review the criteria to be used in the recruitment process and annual assessment of directors.

Recommendation 2.3 : The board should establish formal and transparent remuneration policies and procedures to attract and retain directors.

PRINCIPLE 3: REINFORCE INDEPENDENCE

The board should have policies and procedures to ensure effectiveness of independent directors.

Recommendation 3.1 : The board should undertake an assessment of its independent directors annually.

Recommendation 3.2 : The tenure of an independent director should not exceed a cumulative term of nine years. Upon completion of the nine years, an independent director may continue to serve on the board subject to the director's re-designation as a non-independent director.

Recommendation 3.3 : The board must justify and seek shareholders' approval in the event it retains as an independent director, a person who has served in that capacity for more than nine years.

Recommendation 3.4 : The positions of chairman and CEO should be held by different individuals, and the chairman must be a non-executive member of the board.

Recommendation 3.5 : The board must comprise a majority of independent directors where the chairman of the board is not an independent director.

PRINCIPLE 4: FOSTER COMMITMENT

Directors should devote sufficient time to carry out their responsibilities, regularly update their knowledge and enhance their skills.

Recommendation 4.1 : The board should set out expectations on time commitment for its members and protocols for accepting new directorships.

Recommendation 4.2 : The board should ensure its members have access to appropriate continuing education programmes.

PRINCIPLE 5: UPHOLD INTEGRITY IN FINANCIAL REPORTING

The board should ensure financial statements are a reliable source of information.

Recommendation 5.1 : The Audit Committee should ensure financial statements comply with applicable financial reporting standards.

Recommendation 5.2 : The Audit Committee should have policies and procedures to assess the suitability and independence of external auditors.

PRINCIPLE 6: RECOGNISE AND MANAGE RISKS

The board should establish a sound risk management framework and internal controls system.

Recommendation 6.1 : The board should establish a sound framework to manage risks.

Recommendation 6.2 : The board should establish an internal audit function which reports directly to the Audit Committee.

PRINCIPLE 7: ENSURE TIMELY AND HIGH QUALITY DISCLOSURE

Companies should establish corporate disclosure policies and procedures to ensure comprehensive, accurate and timely disclosures.

Recommendation 7.1 : The board should ensure the company has appropriate corporate disclosure policies and procedures.

Recommendation 7.2 : The board should encourage the company to leverage on information technology for effective dissemination of information.

PRINCIPLE 8: STRENGTHEN RELATIONSHIP BETWEEN COMPANY AND SHAREHOLDERS

The board should facilitate the exercise of ownership rights by shareholders.

Recommendation 8.1 : The board should take reasonable steps to encourage shareholder participation at general meetings.

Recommendation 8.2 : The board should encourage poll voting.

Recommendation 8.3 : The board should promote effective communication and proactive engagements with shareholders.

CONTEMPORARY DEVELOPMENTS IN CORPORATE GOVERNANCE – GLOBALLY

European Commission and legislative framework

The European Commission represents the interests of the European Union (EU) as a whole. It proposes new legislation to the European Parliament and the Council of the European Union, and it ensures that EU law is correctly applied by member countries. The Commission has the right of initiative to propose laws for adoption by the European Parliament and the Council of the EU (national ministers).

Once EU legislation has been adopted, the Commission ensures that it is correctly applied by the EU member countries.

Corporate Governance framework in European Union

The corporate governance framework for listed companies in the European Union is based to a large extent on soft law, namely corporate governance codes. While these corporate governance codes are adopted at national level, EU Directive requires that listed companies refer in their corporate governance statement to a code and

that they report on their application of that code on a 'comply or explain' basis.

European Commission Action Plan – 2012

“European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies”

The European Commission (EC) has adopted an Action Plan on 12th December, 2012 outlining future initiatives in the areas of company law and corporate governance.

The Commission initiated an indepth reflection to evaluate the effectiveness of the current corporate governance rules for European companies. On the basis of its reflection and the results of the consultations, the EC identified several lines of action in the area of company law and corporate governance that are fundamental to putting in place modern legislation for sustainable and competitive companies. The Following are some Key elements of the action plan:

1. Increasing the level of transparency between companies and their shareholders in order to improve corporate governance. This will include in particular:
 - Increasing companies' transparency as regards their board diversity and risk management policies;
 - Improving corporate governance reporting;
 - Better identification of shareholders by issuers;
 - Strengthening transparency rules for institutional investors on their voting and engagement policies.
2. Initiatives aimed at encouraging and facilitating long-term shareholder engagement, such as:
 - More transparency on remuneration policies and individual remuneration of directors, as well as a shareholders' right to vote on remuneration policy and the remuneration report;
 - Better shareholders' oversight on related party transactions, i.e. dealings between the company and its directors or controlling shareholders;
 - Creating appropriate operational rules for proxy advisors (i.e. firms providing services to shareholders, notably voting advice), especially as regards transparency and conflicts of interests;
 - Clarification of the 'acting in concert' concept to make shareholder cooperation on corporate governance issues easier;
 - Investigating whether employee share ownership can be encouraged.
3. Initiatives in the field of company law to support European businesses and encourage their growth and competitiveness:
 - Further investigation on a possible initiative on the cross-border transfer of seats for companies;
 - Facilitating cross-border mergers;
 - Clear EU rules for cross-border divisions;
 - Follow-up of the European Private Company statute proposal with a view to enhancing cross-border opportunities for SMEs;
 - An information campaign on the European Company/European Cooperative Society Statute;
 - Targeted measures on groups of companies, i.e. recognition of the concept of the interest of the group and more transparency regarding the group structure.

In addition, the action plan foresees merging all major company law directives into a single instrument. This

would make EU company law more accessible and comprehensible and reduce the risk of future inconsistencies.

Corporate Governance Codes - Globally

Following are some of the latest Corporate Governance Codes introduced in different jurisdictions:

- Austrian Code of Corporate Governance (Revised 2012)
- Denmark- Recommendations on Corporate Governance (2013)
- German Corporate Governance Code (Revised 2012)
- Jordanian Corporate Governance Code 2012
- Malaysian Code on Corporate Governance 2012
- Mauritius- Guideline on Corporate Governance (2012)
- Maldives- Corporate Governance Codes and Principles 2012
- Pakistan- Code of Corporate Governance 2012
- The Norwegian Code of Practice for Corporate Governance 2012

For details on the aforesaid codes, student may refer the link: http://www.ecgi.org/codes/all_codes.php

LESSON ROUND-UP

- Better regulatory and non-regulatory corporate governance frameworks and enforcement mechanisms are being implemented through tougher company legislation and non-mandatory Corporate Governance Codes
- The ASX Corporate Governance Council issued corporate governance and principles in 2003 which was revised in 2007. Then in 2010 and further revised in 2014.
 - The Recommendations are not prescriptions, they are guidelines, designed to bring out effective governance structure. It is called “if not, why not approach”
 - Majority of the board should be independent directors.
 - The Chairman should be an independent director and the chairman and CEO should not be the same individual.
 - The board is required to establish an audit committee comprising only non-executive directors and majority independent directors.
 - The Board is required to constitute Remuneration Committee and Nomination Committee.
- 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 (the Code), 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.
- The release of King III report on 1 September 2009 represents a significant milestone in the evolution of corporate governance in South Africa and brings with it significant opportunities for organisations that embrace its principles. The King III Report places great emphasis on: Leadership; Sustainability; and Corporate Citizenship.

- The King III Report has 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 UK Corporate Governance Code, 2012 sets out the standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders. Listed Companies are required to report on how they have applied the main principle of the code, and either to confirm that they have complied with the code's provisions or where they not to provide an explanation. The new Code 2012 applies to accounting periods beginning on or after 1 October 2012. The Code is applicable on "Comply or explain basis".
- The Malaysian Code on Corporate Governance 2012 effective from December 31, 2012 is the first deliverable of the CG Blueprint and supercedes the Malaysian Code on Corporate Governance. It sets out broad principles and specific recommendations on structures and processes which companies should adopt in making good corporate governance an integral part of their business dealings and culture.
- The corporate governance framework for listed companies in the European Union is based to a large extent on soft law, namely corporate governance codes. While these corporate governance codes are adopted at national level, EU Directive requires that listed companies refer in their corporate governance statement to a code and that they report on their application of that code on a 'comply or explain' basis.

SELF-TEST QUESTIONS

1. Write a note on 'Comply & Explain' approach.
2. Explain the Board Structure recommended under ASX Corporate Governance Principles and Recommendations.
3. Discuss in brief about the remuneration principles of Singapore Corporate Governance Code.
4. Discuss the functions of Company Secretary provided under the King III Corporate Governance Code for South Africa.
5. Write short notes on:
 - Transparency and Disclosure requirements Australia Corporate Governance Framework
 - Performance Evaluation of directors under UK Corporate Governance Code
 - European Commission Action Plan 2012
 - ASX Corporate Governance Principles and Recommendations

Lesson 13

Corporate Social Responsibility

LESSON OUTLINE

- Introduction
- Concept and meaning of Corporate Social Responsibility (will cover CSR and philanthropy)
- CSR in India
- CSR Voluntary Guidelines, 2009
- National Voluntary Guidelines on Social, Economic and Environmental Responsibilities of Businesses, 2011
- Companies Act, 2013
- Companies (Corporate Social Responsibility Policy) Rules, 2014
- Corporate Citizenship- Beyond mandate of Law.
- ISO 26000
- CSR Audit
- Annexure
- 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: “its refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society”.

According to Business for Social Responsibility (BSR) “Corporate social responsibility is operating a business in a manner which meets or excels the ethical, legal, commercial and public expectations that a society has from the business.”

Business entity is expected to undertake those activities, which are essential for betterment of the society. Every aspect of business has a social dimension. Corporate Social Responsibility means open and transparent business practices that are based on ethical values and respect for employees, communities and the environment. It is designed to deliver sustainable value to society at large as well as to shareholders.

Corporate Social Responsibility is nothing but what an organisation does, to positively influence the society in which it exists. It could take the form of community relationship, volunteer assistance programmes, and special

scholarships, preservation of cultural heritage and beautification of cities. The philosophy is basically to return to the society what it has taken from it, in the course of its quest for creation of wealth.

With the understanding that businesses play a key role of job and wealth creation in society, CSR is generally understood to be the way a company achieves a balance or integration of economic, environmental, and social imperatives while at the same time addressing shareholder and stakeholder expectations.

According to CSR Asia, a social enterprise, “CSR is a company’s commitment to operate in an economically, socially and environmentally sustainable manner whilst balancing the interests of diverse stakeholders”

CSR is generally accepted as applying to firms wherever they operate in the domestic and global economy. The way businesses engage/involve the shareholders, employees, customers, suppliers, Governments, non-Governmental organizations, international organizations, and other stakeholders is usually a key feature of the concept. While an organisation’s compliance with laws and regulations on social, environmental and economic objectives set the official level of CSR performance, it is often understood as involving the private sector commitments and activities that extend beyond this foundation of compliance with laws.

The term Corporate Social responsibility refers to the concept of business being accountable for how it manages the impact of its processes on stakeholders and takes responsibility for producing a positive effect on society.

According to the Commission of the European Communities, 2003, “CSR is the concept that an enterprise is accountable for its impact on all relevant stakeholders. It is the continuing commitment by business to behave fairly and responsibly and contribute to economic development while improving the quality of life of the work force and their families as well as of the local community and society at large.”

According to the World Business Council for Sustainable Development, 1999 “Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to the economic development while improving the quality of life of the workforce and their families as well as of the local community and the society at large.”

CSR is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis. The main function of an enterprise is to create value through producing goods and services that society demands, thereby generating profit for its owners and shareholders as well as welfare for society, particularly through an ongoing process of job creation. However, new social and market pressures are gradually leading to a change in the values and in the horizon of business activity.

Essentially, Corporate Social Responsibility is an inter-disciplinary subject in nature and encompasses in its fold:

1. Social, economic, ethical and moral responsibility of companies and managers,
2. Compliance with legal and voluntary requirements for business and professional practice,
3. Challenges posed by needs of the economy and socially disadvantaged groups, and
4. Management of corporate responsibility activities.

CSR is an important business strategy because, wherever possible, consumers want to buy products from companies they trust; suppliers want to form business partnerships with companies they can rely on; employees want to work for companies they respect; and NGOs, increasingly, want to work together with companies seeking feasible solutions and innovations in areas of common concern. CSR is a tool in the hands of corporates to enhance the market penetration of their products, enhance its relation with stakeholders. CSR activities carried out by the enterprises affects all the stakeholders, thus making good business sense, the reason being contribution to the bottom line.

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.

- 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.
- 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.
- 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.

- Public needs have changed leading to changed expectations from consumers. The industry/ business owe its very existence society and have to respond to needs of the society.
- 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.
- The internal activities of the organisation have an impact on the external environment, since the society is an inter-dependent system.
- 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.
- 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.
- 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.
- Companies can better address the grievances of its employees and create employment opportunities for the unemployed.
- 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.
- 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.
- 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

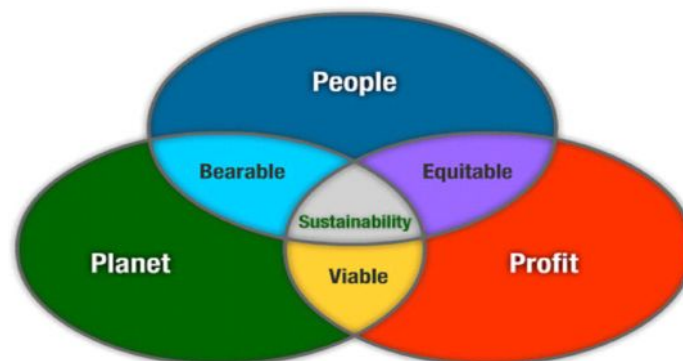
Many factors and influences, including the following, have led to increasing attention being devoted to CSR:

- 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 –

- Increased consumer sensitivity to corporate social behaviour
- Growing demands for transparency from shareholders/stakeholders
- Increased environmental regulation
- Legal costs of compliances and defaults
- Concerns over global warming
- Increased social awareness
- Awareness about and willingness for respecting human rights
- Media's attention to social issues
- 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

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 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 are underway 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.

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.

CORPORATE SOCIAL RESPONSIBILITY VOLUNTARY GUIDELINES, 2009

The **Corporate Social Responsibility Voluntary Guidelines, 2009** issued by the Ministry of Corporate Affairs was a recommendatory initiative which underlined 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. It is recognized world over that integrating social, environmental and ethical responsibilities into the governance of businesses ensure 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.

The CSR activity that a company pursues must be **aligned** to the business of the company; this ensures that such CSR also contributes to the growth of the company on a wider scale. It is not about pursuing an activity of CEO's interest but should be relevant to company's business. CSR is a much more holistic approach to business, which is designed to enhance corporate success because of its relevance, rather than represent something unconnected to an organization's core business. This is a win-win model.

NESTLE - Moga Milk Factory

The Company started milk collection in Moga in 1961 with a collection of 511 Kgs of milk from 180 farmers. Nestlé Agricultural Services has used the experience gained by Nestlé across the world to set up a system of direct and efficient contact with the farmers. Company veterinarians and agronomists supervise the milk routes and advise farmers on various issues including proper feed for the herds. Milk storage facilities have been set up close to the farmers. Veterinary services are provided free, and medicines provided at wholesale cost. The company assists farmers in artificial insemination programs for their cattle, provides subsidy and helps them in procuring loans.

By working very closely with the farmers of the Moga Milk District and local administrators, Nestlé has helped to raise the quality and hygiene of the milk produced there and improve the health and life style of the farmers and other residents. Its contribution to the creation of prosperity on an on-going and sustainable basis has not only transformed Moga into a prosperous and vibrant milk district today, but also a thriving hub of industrial activity.

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).

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:

1. Care for all Stakeholders: 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.

2. Ethical functioning: 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.

3. Respect for Workers: Rights and Welfare: 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.

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.

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:
 - 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 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**” that will mainstream the subject of business responsibilities. The Guidelines were released by MCA on July 8, 2011.

These guidelines have been 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.

The principles and the core elements of each of the principles as recommended by the National Voluntary Guidelines are summarized below:

Principle 1: Businesses should conduct and govern themselves with Ethics, Transparency and Accountability

The principle recognizes that ethical conduct in all functions and processes is the cornerstone of responsible business.

1. Businesses should develop governance structures, procedures and practices that ensure ethical conduct at all levels; and promote the adoption of this principle across its value chain. Businesses should communicate transparently and assure access to information about their decisions that impact relevant stakeholders.
2. Businesses should not engage in practices that are abusive, corrupt, or anti-competition.
3. Businesses should truthfully discharge their responsibility on financial and other mandatory disclosures.
4. Businesses should report on the status of their adoption of these Guidelines as suggested in the reporting framework in NVG's.
5. Businesses should avoid complicity with the actions of any third party that violates any of the principles contained in these Guidelines

Principle 2: Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle

The principle recognizes that all stages of the product life cycle, right from design to final disposal of the goods and services after use, have an impact on society and the environment. Responsible businesses, therefore, should engineer value in their goods and services by keeping in mind these impacts.

1. Businesses should assure safety and optimal resource use over the life-cycle of the product – from design to disposal – and ensure that everyone connected with it- designers, producers, value chain members, customers and recyclers are aware of their responsibilities.
2. Businesses should raise the consumer’s awareness of their rights through education, product labelling, appropriate and helpful marketing communication, full details of contents and composition and promotion of safe usage and disposal of their products and services.
3. In designing the product, businesses should ensure that the manufacturing processes and technologies required to produce it are resource efficient and sustainable.
4. Businesses should regularly review and improve upon the process of new technology development, deployment and commercialization, incorporating social, ethical, and environmental considerations.
5. Businesses should recognize and respect the rights of people who may be owners of traditional knowledge, and other forms of intellectual property.
6. Businesses should recognize that over-consumption results in unsustainable exploitation of our planet’s resources, and should therefore promote sustainable consumption, including recycling of resources.

Principle 3: Businesses should promote the well being of all employees

The principle encompasses all policies and practices relating to the dignity and well being of employees engaged within a business or in its value chain.

1. Businesses should respect the right to freedom of association, participation, collective bargaining, and provide access to appropriate grievance redressal mechanisms.
2. Businesses should provide and maintain equal opportunities at the time of recruitment as well as during the course of employment irrespective of caste, creed, gender, race, religion, disability or sexual orientation.
3. Businesses should not use child labour, forced labour or any form of involuntary labour, paid or unpaid.
4. Businesses should take cognizance of the work-life balance of its employees, especially that of women.
5. Businesses should provide facilities for the well being of its employees including those with special needs. They should ensure timely payment of fair living wages to meet basic needs and economic security of the employees.
6. Businesses should provide a workplace environment that is safe, hygienic humane, and which upholds the dignity of the employees. Business should communicate this provision to their employees and train them on a regular basis.
7. Businesses should ensure continuous skill and competence upgrading of all employees by providing access to necessary learning opportunities, on an equal and non-discriminatory basis. They should promote employee morale and career development through enlightened human resource interventions.
8. Businesses should create systems and practices to ensure a harassment free workplace where employees feel safe and secure in discharging their responsibilities.

Principle 4: Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized.

The principle recognizes that businesses have a responsibility to think and act beyond the interests of its shareholders to include all their stakeholders.

1. Businesses should systematically identify their stakeholders, understand their concerns, define purpose and scope of engagement, and commit to engaging with them.
2. Businesses should acknowledge, assume responsibility and be transparent about the impact of their policies, decisions, product & services and associated operations on the stakeholders.
3. Businesses should give special attention to stakeholders in areas that are underdeveloped.
4. Businesses should resolve differences with stakeholders in a just, fair and equitable manner

Principle 5: Businesses should respect and promote human rights

The principle takes into account the “Corporate Responsibility to Respect Human Rights”, as referred in the United Nations “Protect, Respect, Remedy” Framework.

1. Businesses should understand the human rights content of the Constitution of India, national laws and policies and the content of International Bill of Human Rights. Businesses should appreciate that human rights are inherent, universal, indivisible and interdependent in nature.
2. Businesses should integrate respect for human rights in management systems, in particular through assessing and managing human rights impacts of operations, and ensuring all individuals impacted by the business have access to grievance mechanisms.
3. Businesses should recognize and respect the human rights of all relevant stakeholders and groups within and beyond the workplace, including that of communities, consumers and vulnerable and marginalized groups.
4. Businesses should, within their sphere of influence, promote the awareness and realization of human rights across their value chain.
5. Businesses should not be complicit with human rights abuses by a third party.

Principle 6: Business should respect, protect, and make efforts to restore the environment

The principle recognizes that environmental responsibility is a prerequisite for sustainable economic growth and for the well being of society.

1. Businesses should utilize natural and manmade resources in an optimal and responsible manner and ensure the sustainability of resources by reducing, reusing, recycling and managing waste.
2. Businesses should take measures to check and prevent pollution. They should assess the environmental damage and bear the cost of pollution abatement with due regard to public interest.
3. Businesses should ensure that benefits arising out of access and commercialization of biological and other natural resources and associated traditional knowledge are shared equitably.
4. Businesses should continuously seek to improve their environmental performance by adopting cleaner production methods, promoting use of energy efficient and environment friendly technologies and use of renewable energy.
5. Businesses should develop Environment Management Systems (EMS) and contingency plans and processes that help them in preventing, mitigating and controlling environmental damages and disasters, which may be caused due to their operations or that of a member of its value chain.

6. Businesses should report their environmental performance, including the assessment of potential environmental risks associated with their operations, to the stakeholders in a fair and transparent manner.
7. Businesses should proactively persuade and support its value chain to adopt this principle.

Principle 7: Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner

The principle recognizes that businesses operate within the specified legislative and policy frameworks prescribed by the Government, which guide their growth and also provide for certain desirable restrictions and boundaries.

1. Businesses, while pursuing policy advocacy, must ensure that their advocacy positions are consistent with the Principles and Core Elements contained in these Guidelines.
2. To the extent possible, businesses should utilize the trade and industry chambers and associations and other such collective platforms to undertake such policy advocacy.

Principle 8: Businesses should support inclusive growth and equitable development

The principle recognizes the value of the energy and enterprise of businesses and encourages them to innovate and contribute to the overall development of the country, especially to that of the disadvantaged, vulnerable and marginalised sections of society.

1. Businesses should understand their impact on social and economic development, and respond through appropriate action to minimise the negative impacts.
2. Businesses should innovate and invest in products, technologies and processes that promote the well being of society.
3. Businesses should make efforts to complement and support the development priorities at local and national levels, and assure appropriate resettlement and rehabilitation of communities who have been displaced owing to their business operations.
4. Businesses operating in regions that are underdeveloped should be especially sensitive to local concerns.

Principle 9: Businesses should engage with and provide value to their customers and consumers in a responsible manner

This principle is based on the fact that the basic aim of a business entity is to provide goods and services to its customers in a manner that creates value for both.

1. Businesses, while serving the needs of their customers, should take into account the overall well-being of the customers and that of society.
2. Businesses should ensure that they do not restrict the freedom of choice and free competition in any manner while designing, promoting and selling their products.
3. Businesses should disclose all information truthfully and factually, through labelling and other means, including the risks to the individual, to society and to the planet from the use of the products, so that the customers can exercise their freedom to consumer in a responsible manner. Where required, businesses should also educate their customers on the safe and responsible usage of their products and services.
4. Businesses should promote and advertise their products in ways that do not mislead or confuse the consumers or violate any of the principles in these Guidelines.
5. Businesses should exercise due care and caution while providing goods and services that result in over exploitation of natural resources or lead to excessive conspicuous consumption.
6. Businesses should provide adequate grievance handling mechanisms to address customer concerns and feedback.

The NVG framework has 36 parameters reflecting nine key principles related to responsible business practices.

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. While the Guidelines encompassing nine Principles and related Core Elements identify the areas where responsible practices need to be adopted, the Reporting Framework provides a standard disclosure template which can be used by businesses to report on their performance in these areas. The reporting aspect of these guidelines have been dealt elsewhere in the study material.

CORPORATE SOCIAL RESPONSIBILITY UNDER THE COMPANIES ACT, 2013

The requirement of undertaking Corporate Social Responsibility by companies has been introduced in Section 135 of Companies Act, 2013. This section needs to read along with Companies (Corporate Social Responsibility Policy) Rules, 2014 and Schedule VII to the Act. Section 135 provides that

- (1) 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.
- (2) The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.
- (3) The Corporate Social Responsibility Committee shall –
 - (a) 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;
 - (b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
 - (c) monitor the Corporate Social Responsibility Policy of the company from time to time.
- (4) The Board of every company referred to in sub-section (1) shall, –
 - (a) 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, if any, in such manner as may be prescribed; and
 - (b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.
- (5) The Board of every company referred to in sub-section (1), 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:

Provided that 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. Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount.

Explanation. – For the purposes of this section “average net profit” shall be calculated in accordance with the provisions of section 198.

Accordingly, every company – private company or public company, beyond the thresholds specified below is required to constitute CSR Committee:

- Net worth of Rs.500 crore or more; or

- Turnover of Rs.1000 crore or more; or
- Net profit of Rs. 5 crore or more during any financial year.

The Board of every company referred above shall ensure that the company spends, in every financial year, at least two per cent of the net profits of the company made during the three immediately preceding financial years in pursuance of its CSR policy.

Further, 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.

If the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount.

COMPOSITION OF CSR COMMITTEE

The CSR committee shall consist of three or more directors, out of which one director shall be an independent director. The presence of an Independent Director shall ensure that the Committee is not just a quasi-committee addressing the whims of the Board, but is in fact, taking up an initiative. The composition of such Corporate Social Responsibility Committee shall have to be disclosed in the Board's Report as required under Section 134(4).

An unlisted public company or a private company which is not required to appoint an independent director shall have its CSR Committee without independent director. A private company having only two directors on its Board shall constitute its CSR Committee with two such directors. With respect of foreign company, the CSR Committee shall comprise of at least two persons of which one person resident in India and another person shall be nominated by the foreign company.

The CSR Committee shall institute a transparent monitoring mechanism for implementation of CSR projects or programs or activities undertaken by the company.

FUNCTIONS OF THE CSR COMMITTEE

The 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 of the Act. The Committee shall also initiate a CSR Policy, which shall stipulate how, where, and when they want to invest their funds with respect to this requirement.

The Committee shall recommend the amount of expenditure to be incurred on the activities referred to above. Further, the CSR Committee is under an obligation to monitor the implementation of the CSR policy from time to time.

CSR POLICY

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.

COMPANIES (CORPORATE SOCIAL RESPONSIBILITY POLICY) RULES, 2014

The MCA has also notified the Companies (Corporate Social Responsibility Policy) Rules, 2014 ('the Rules') to be effective from 1 April 2014. The Rules have just released and as these are evaluated in detail, further areas requiring clarity may emerge. The salient features of the Rules are as follows:

Rule 1	Short Title and Commencement
Rule 2	Definitions
Rule 3	Applicability of CSR
Rule 4	CSR Activities
Rule 5	CSR Committees
Rule 6	CSR Policy
Rule 7	CSR Expenditure
Rule 8	CSR Reporting
Rule 9	Disclosure

(1) Short title and commencement. – (1) These rules may be called the Companies (Corporate Social Responsibility Policy) Rules, 2014

(2) they shall come into force on the 1st day of April, 2014

(2) Definitions – (1) in these rules, unless the context otherwise requires,

- (a) “Act ” means the Companies Act, 2013;
- (b) “Annexure” means the Annexure appended to these rules;
- (c) “Corporate Social Responsibility (CSR)” means and include but is not limited to:-
 - (i) Projects or programs relating to activities specified in Schedule VII to the Act; or
 - (ii) Projects or programs relating to activities undertaken by the board of directors of the company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.
- (d) “CSR Committee” means the Corporate Social Responsibility Committee of the Board referred to in section 135 of the Act.
- (e) “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;
- (f) “Net Profit” means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following namely:-
 - (i) any profit arising from any overseas branch or branches of the company or otherwise; and
 - (ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act:

Provided that the net profit in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956, (1 of 1956) shall not be required to be re-calculated in accordance with the provisions of the Act.

Provided further, that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (1) of section 381 read with section 198 of the Act. Further, words and expressions used and not defined in these rules but defined in the Act shall have the same meaning respectively assigned to them in the Act.

(3) Corporate Social Responsibility – (1) Every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, which fulfills the criteria specified in sub-section (1) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules:

Provided that net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and profit and loss account of such company prepared in accordance with the provisions of clause (a) of sub section (1) of section 381 and section 198 of the Act.

(2) Every company which ceases to be a company covered under sub-section (1) of section 135 of the Act for three consecutive financial years shall not be required to-

- (a) constitute a CSR Committee; and
- (b) 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

(4) CSR Activities – (1) The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

(2) The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered trust or a registered society or a company established by the company or its holding or subsidiary or associate company under section 8 of the Act or otherwise:

Provided that –

- (i) If such trust, society or company is not established by the 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.

(3) A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committee of respective companies are in a positions to report separately on such projects or programs in accordance with these rules.

(4) Subject to provisions of sub-section (5) of section 135 of the Act, the CSR projects or programs or activities undertaken in India only shall amount to CSR Expenditure.

(5) The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

(6) Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through institutions with established track records of atleast three financial years but such expenditure shall not exceed five percent of total CSR expenditure of the company in one financial year.

(7) Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

322 PP-EGAS

Schedule VII of Companies Act, 2013 describes activities to be undertaken as CSR :

- eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water;
- promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;
- promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
- ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agro forestry, conservation of natural resources and maintaining quality of soil, air and water;
- 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;
- measures for the benefit of armed forces veterans, war widows and their dependents;
- training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports;
- contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;
- contributions or funds provided to technology incubators located within academic institutions
- which are approved by the Central Government
- rural development projects

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.
- Salaries paid by the companies to regular CSR staff as well as to volunteers of the companies (in proportion to company's time/hours spent specifically on CSR) can be factored into CSR project cost as part of the CSR expenditure.
- 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.

(5) CSR Committees – (1) The companies mentioned in the rule 3 shall constitute CSR Committee as under:-

(i) an unlisted public company or a private company covered under sub-section (1) of section 135 which is not required to appoint an independent director pursuant to sub-section (1) of section 135 which is not required to appoint an independent director pursuant to sub-section 4 of section 149 of the Act, shall have its CSR Committee without such director;

(ii) a private company having only two directors on its Board shall constitute its CSR Committee with two such directors;

(iii) with respect to a foreign company covered under these rules, the CSR Committee shall comprise of atleast two persons of which one person shall be a specified under clause (d) of sub-section 1 of section 380 of the Act and another person shall be nominated by the foreign company.

(2) The CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

(6) CSR Policy – (1) The CSR Policy of the company shall, inter-alia, include the following namely:-

(a) a list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedules for the same; and

(b) monitoring process of such projects or programs;

Provided that the CSR activities does not include the activities undertaken in pursuance of normal course of business of a company.

Provided further that the Board of Directors shall ensure that activities include by a company and its Corporate Social Responsibility Policy are related to the activities include in the Schedule VII of the Act.

(2) The CSR Policy of the company shall specify that the surplus arising out of the CSR Projects or programs or activities shall not form part of the business profit of a company.

(7) CSR Expenditure – CSR expenditure shall include all expenditure including contribution to corpus for projects or programs relating to CSR activities approved by the Board on the recommendation of its CSR Committee, but does not include any expenditure on an item not in conformity or not in line with activities which falls within the purview of Schedule VII of the Act.

(8) CSR Reporting – (1) The Board's Report of a company covered under these rules pertaining to a financial year commencing on or after the 1st day of April, 2014 shall include an annual report on CSR containing particulars specified in Annexure.

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

(9) Display of CSR activities in its website – The Board of Directors of the company shall, after taking into account the recommendations of CSR Committee, approve the CSR Policy of the company and disclose contents of such policy in its report and the same shall be displayed on the company's website, if any, as per the particulars specified in the **Annexure**.

CORPORATE CITIZENSHIP - BEYOND THE MANDATE OF LAW

Government regulation and public policy tend to bring the bare minimum involvement by the corporates towards their corporate responsibilities beyond this legal framework should come up voluntarily.

Before the enactment of the Companies Act, 2013, the laws in India took care of the basic CSR included various legislations under labour laws such as Factories Act, 1948, ESI Act, 1948, Employees Compensation Act, 1923, Contract Labour (Regulation and Abolition) Act, 1970, Equal Remuneration Act, 1976, The Minimum Wages Act, 1948, Employees' Provident Fund and Miscellaneous Provisions Act, 1952, environment protection laws such as The Water (Prevention and Control of Pollution) Act, 1974, The Air (Prevention and Control of Pollution) Act, 1981 and the Environment Protection Act, 1986

The main object of the **Factories Act, 1948** is to ensure adequate safety measures and to promote the health and welfare of the workers employed in factories. The Act also makes provisions regarding employment of women and young persons (including children and adolescents), annual leave with wages etc.

The **Employees' State Insurance Act, 1948** provides for certain benefits to employees in case of sickness, maternity and employment injury and also makes provisions for certain other matters in relation thereto.

The **Employees Compensation Act, 1923** is a social security legislation. It imposes statutory liability upon an employer to discharge his moral obligation towards his employees when they suffer from physical disabilities and diseases during the course of employment in hazardous working conditions. The Act also seeks to help the dependents of the workmen rendered destitute by the 'accidents' and from the hardship arising out from such accidents.

In 1972, the Department of Science and Technology set up a National Committee on Environmental Planning and Coordination to identify and investigate problems of preserving or improving the human environment and also to propose solutions for environmental problems. In 1977, by an amendment to the Constitution, Article 48A was introduced imposing a duty on the State to protect and improve the environment and safeguard the forests and wildlife of the country. Article 51A also, provides for the protection and improvement of the natural environment including forests, lakes, rivers and wild life and to have compassion for living creatures.

The Water (Prevention and Control of Pollution) Act was enacted in 1974 and the Air (Prevention and Control of Pollution) Act was passed by the Union of India in 1981.

In 1986, the Government enacted the Environment Protection Act to provide for the protection and improvement of environment and the prevention of hazards to human beings, other living creatures, plants and property.

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.

Tata Steel: A Company that also makes steel

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.

CSR STANDARD - ISO 26000

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.

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.

CSR ASSESSMENT

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.

Indicative CSR Audit Programme

Segments	Assessment Tools	Scope
Objectives	Coverage	The exhaustiveness of CSR objectives
	Integration	The extent to which the CSR objectives of the company are aligned with its business goals.
	Commitment	The clarity of roles and powers assigned to management for fulfillment of CSR objectives. Integration of Social responsibility throughout the organisation.
Implementation	Processes	Identification of the implementation procedures, time frames, risk and performance management tools for fulfilment of CSR objectives. Manner of delivering CSR activities either by way of foundation/ Trust route or by imbibing them into day to day activities.
	Resources	Allocation of funds, manpower, infrastructure etc.
	Monitoring/Reporting	Internal control systems to monitor the adequacy of mechanisms (including periodic reviews) in relation to fulfillment of CSR objectives. Reporting: Communication of adequate data in relation to CSR objectives to various stakeholders.
Outcome	Impact Analysis	Analysing the impact of CSR activities carried out by the company in various areas and the quality maintained.
	Feedback	Identification of control weaknesses and make recommendations for improvement to CSR programs of the company. Identification of areas requiring changes.

CONCLUSION

The Friedman's formulation that "The business of business is business" has outlived its utility, and social responsibility and being a good corporate citizen are the buzzwords today. In the long run, those organizations or group of persons who do not exercise power in a way which society considers responsible, will tend to lose it.

ANNEXURE

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:

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
S No	CSR project or activity identified	Sector in which the project is covered	Projects or programs (1) Local area or other (2) Specify the State and district where projects or programs was taken	Amount outlay (budget) project or programs wise	Amount spent on the projects or programs Sub-heads: (1) Direct expenditure on projects or programs (2) Overheads:	Cumulative expenditure upto the reporting period.	Amount spent: Direct or through implementing agency
1							
2							
3							
	TOTAL						

* 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/- (Chairan CSR Committee)	Sd/- (Person specified under clause (d) of sub section (1) of section 380 of the Act) (wherever applicable)
--	---------------------------------	---

LESSON ROUND-UP

- Sustainable business success and shareholder value cannot be achieved solely through maximising short-term profits, but instead through market-oriented yet responsible behaviour.
- Corporate Social Responsibility is also called Corporate Citizenship or Corporate Responsibility.
- CSR is generally understood to be the way a company achieves a balance or integration of economic, environmental, and social imperatives.
- Corporate Social Responsibility under the Companies Act, 2013
- Corporate citizenship is a commitment to improve community well-being through voluntary business practices and contribution of corporate resources leading to sustainable growth.
- Philanthropy means the act of donating money, goods, time or effort to support a charitable cause in regard to a defined objective.
- The social responsibility of business can be integrated into the business purpose so as to build a positive synergy between the two.
- Triple Bottom Line Approach of CSR - “People, Planet and Profit” is used to succinctly describe the triple bottom lines.

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 14

Sustainability

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 the study lesson is to enable the students to understand concept of Sustainability, its meaning and scope, familiarize with sustainability terminologies being used widely. The study focus on the Corporate Sustainability and role of corporate & other stakeholders in sustainable development; Government Initiative to improve sustainability reporting. Students will be able to recognize the difference between CSR and Sustainability, 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 permit fulfilling the social, economic and other requirements of present and future generations.

Sustainability is important to making 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.

It indicates development that meets the needs of the present generation without compromising 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 needs of the future generation are not impaired. For example, natural energy resources like Coal, Petroleum etc., should be prudently used and wastage should be avoided so that future generation can have 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 industry has a significant role to play. 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, they have been a huge cause of some of the unsustainable conditions, and on 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. Second, it provides a common societal goal for corporations, governments, and civil society to work toward: 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 to meet the needs of stakeholders today while seeking to protect, support and enhance the human and natural resources that will be needed in the future.

Four fundamental Principle of Sustainable Development agreed by the world community are:

1. *Principle of Intergenerational equity*: need to preserve natural resources for future generation.
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 people coming ahead, the generations still unborn, have a world no worse than ours and hopefully better.

The generations followed these fundamental natural laws for thousands of years. However, scenario started changing rapidly during industrial revolution in Europe and afterwards this started growing side by side with advancement 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 defined, “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 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. Through the process a business can ensure that markets, commerce, technology and finance advance in ways that benefit economies and societies everywhere.

This is the first initiative under which business world is being aligned to common goals, such as building markets, combating corruption, safeguarding the environment and ensuring social inclusion, and it has resulted in unprecedented partnerships and openness among business, government, civil society, labour and the United Nations. Over 4700 corporate from over 130 countries are 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 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:

332 PP-EGAS

- Adopting an established and globally recognized policy framework for the development, implementation, and disclosure of 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 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.

In summary, 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, 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 reduces carbon in the atmosphere. An individual can also engage 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.

Carbon Neutral

Through carbon offsetting organisation to individual 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 for 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 harmless the corresponding waste, given prevailing technology and resource management practice.

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 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 that help produce a product and to minimise the 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 and human induced. In common usage, "global warming" often refers to the warming that can occur as a result of increased emissions of greenhouse gases from human activities. See climate change, greenhouse effect, enhanced greenhouse effect, radiative forcing, troposphere.

Greenhouse effect

Gases produced naturally and by 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 impacts of a product from its raw materials through 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 environmental protection, social justice and equity, and economic development are given more significant focus while recognizing simultaneous corporate growth 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 needed in 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, communities, etc.) 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 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 stakeholders, are now basic and fundamental issues which permits a corporate to operate in 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 advantage.

Social impact assessment – In order to become sensitive to various social factors, like changes in culture, living habits etc.

Repositioning capability through development and innovation. Crystallisation of all activities to ensure consistent growth

Corporate sustainability is a business approach creating shareholder value in 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 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 its goal towards creation of absolute value to the society. Once it is ensured, a corporate never looks back and its sustainability in 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 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. When they were banned by the WHO or other authorities, they had to stop their production.

Worth of Earth through Environmental Protection

Resources which are not ubiquitous and have economic and social value should be preserved for 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 divulge themselves in unfair means and it should create candid business practices, ensure healthy competition and fair trade practices.

Corporate Social Responsibility

As a Corporate citizen, every corporate is duty bound to its society wherein they operate and serve. Although there is 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 brings 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, price not reflecting real economic, social environmental cost, etc. are hindrances to sustainability of a business. Simultaneously, a corporate is to build up its products and services in such a way so as to cater all segments of customers/consumers. Customer confidence is essence to corporate success.

Switching over from Stakeholders Dialogue to holistic Partnership

A business enterprises can advance their activities very positively if it makes all of stakeholders partner in its progress. It not only build confidence of various 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 alliance towards bringing common solutions to common concerns being faced by all.

Compliance of Statutes

Compliance of statutes, rules and regulations, standards set by various bodies ensure clinical check up of a corporate and it confers societal license to the corporate to run and operate 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 the 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, having taken due account of the 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 Corporate Sustainability. The first recognized contribution in the literature dates back to Bowen, who stressed the responsibilities of businesses and wrote that social responsibility refers to the obligations of 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 profitable and obey the law), companies are expected to satisfy other requirements, relevant to conformity to social norms and voluntary contributions to the community in which they operate. Another important Corporate Social Responsibility approach developed during the 1980s in the light of the growth of the stakeholder approach, firms have obligations to a broader group of stakeholders than the simple shareholders, where a stakeholder is any group or 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 gave different roots and gave developed along diverse theoretical paths, they ultimately converged. This strong complementarity is evident in some recent definitions of 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 respect for employees, communities and the environment. It is designed to deliver sustainable value to society at large, as well as to shareholders.

The concept of sustainable development has been transposed from the macro to the corporate dimension. Companies, in fact, are a productive resource of our socio-economic system and key to the eventual implementation of sustainability. According to 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 SD 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 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 material—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 regulation 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 between the company and –

- Customers
- Suppliers
- Competitors

338 PP-EGAS

- 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 it is concerned with profit making and for 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 each other, 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 did 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 in to partnership agreements and joint ventures, which results and 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 activities that they do for common good. For e.g. ATM facility of one bank, following the central bank guidelines can be used by customer of 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. At this stage company cares for all its direct stakeholders including its local community and beyond, 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, improve the standard of living of 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 toward 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 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.

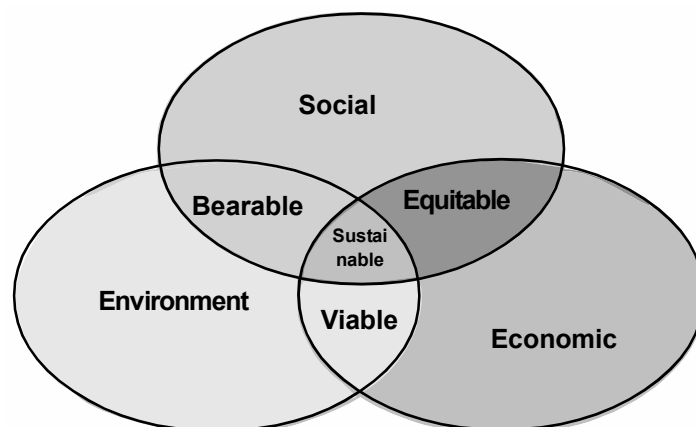
THE CORPORATE PHILOSOPHY OF CANON IS KYOSEI.

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 were inseparable from the societies and environments 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. 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

Source: Wikipedia

The Triple Bottom Line is made up of “Social, Economic and Environmental” aspect and indicated by the phrase “People, Planet, Profit” phrase .

“People” means Human Capital. It implies fair and beneficial business practices toward labour and the community and region in which a corporation conducts its business would create long term value. Well being 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 nature or create 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.

A TBL company as a corporate policy debars itself from manufacturing harmful or destructive products such as weapons, toxic chemicals etc. those are injurious to the 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 the organization has on its business activities and that too after meeting all social and environmental cost. It somehow indicates real value addition a corporate made through its various activities.

World wide 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 comtemplating how to integrate this triple bottom line under their legal system.

CONCLUSION

Leading sustainability companies display high levels of competence in addressing global and industry 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 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 and 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 Stakeholder: Setting the highest standards of corporate governance and stakeholder 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 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 performance 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 as per 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 change 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 government regulators and policy makers. It recognized that industry has a significant role to play.
- Four fundamental Principle of Sustainable Development- 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 labour. Third is cooperating outside the company. Fourth is global activism, and 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 environments 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 environmentalist and pressure groups to one 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 of business 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

- Introduction
- Global Reporting Initiative (GRI)
- GRI Guidelines
- UN Global Compact
- CSR Reporting Framework
- Business Responsibility Reporting in India
- UN-Principles for Responsible Investment (PRI)
- Sustainability Indices
- Benefits of Sustainability Reporting
- Challenges In Mainstreaming Sustainability Reporting
- Contemporary Developments-Integrated Reporting
- Development of Successful Sustainability Report
- Sustainability Reporting in Emerging Economies
- Sustainability Reporting – Case Studies
- 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 Sustainability Accounting and Sustainability Reporting and Global Reporting Initiative Guidelines framework for reporting used worldwide.

The study aims to develop an understanding of the concept of sustainability reporting amongst the students.

The study covers the business responsibility concept in India; various sustainability indices and UN principles for responsible investment. The study also covers the following:

- Reporting as per Communication of Progress under the UN Global Compact
- Benefits of Sustainability Reporting
- Challenges In Mainstreaming Sustainability Reporting
- Development of successful sustainability report
- Integrated Reporting
- Case Studies on Sustainability Reporting
- Sustainability Reporting in Emerging Economies
- FAQs on SEBI Circular - Business Responsibility Reports

INTRODUCTION

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.

The concept of sustainability reporting is of recent origin. Conventionally financial accounting was the tool that aided management control. Since 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 broad term considered synonymous with others used to describe reporting on economic, environmental, and social impacts (e.g. triple bottom line, corporate responsibility reporting, etc.). Sustainability reporting is a practice to measure, disclose, and be accountable to internal and external stakeholders for organisational, environmental, social and economic performance.

Sustainability reporting is becoming more prevalent, driven by a growing recognition that sustainability related issues can materially affect a company's performance; demands from various stakeholder groups for increased levels of transparency and disclosure; and the need for companies (and the business community more generally) to appropriately respond to issues of sustainable development.

Sustainability reporting is increasingly being recognized as a priority for sustainable development. Paragraph 47 of the outcome document of United Nations Conference on Sustainable Development, 2012 (popularly known as Rio +20) "The Future We Want" states:

"We acknowledge the importance of corporate sustainability reporting and encourage companies, where appropriate, especially publicly listed and large companies, to consider integrating sustainability information into their reporting cycle. We encourage industry, interested governments as well as relevant stakeholders with the support of the UN system, as appropriate, to develop models for best practice and facilitate action for the integration of sustainability reporting, taking into account the experiences of already existing frameworks, and paying particular attention to the needs of developing countries, including for capacity building."

Key drivers of sustainability reporting

- Regulations. Governments at most levels have stepped up the pressure on corporations to ensure 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 firms to provide much more information about the products they produce, the suppliers who produce them, and the product's environmental impact 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 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.
- The Carbon Disclosure Project was developed in response to investor demand for a system for firms to measure and report greenhouse gas emissions and climate change strategies as a tool to set reduction targets and set individual goals. [Global trends in sustainability performance management, Economist Intelligence Unit Limited 2010]

Business Responsibility Reporting in India

Realizing that 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. This is all the more relevant for listed entities which, considering the fact that they have accessed funds from the public, have an element of public interest involved

Securities and Exchange Board of India (SEBI) vide circular CIR/CFD/DIL/ 8/2012 dated August 13, 2012 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.

As a starting phase, the SEBI circular requirement to include BR Reports as part of the Annual Reports shall be mandatory for top 100 listed entities based on market capitalisation at BSE and NSE as on March 31, 2012. Other listed entities may voluntarily disclose BR Reports as part of their Annual Reports.

Those listed entities which have been submitting sustainability reports to overseas regulatory agencies/ stakeholders based on internationally accepted reporting frameworks (like Global Reporting Initiative (GRI), UN Global Compact (UNGC) need not prepare a separate report for the purpose of these guidelines but only furnish the same to their stakeholders along with the details of the framework under which their BR Report has been prepared and a mapping of the principles contained in these guidelines to the disclosures made in their sustainability reports.

The aforesaid circular is based on National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (NVG) issued by Ministry of Corporate Affairs (MCA) in 2011.

Overview of the Suggested Framework

As per the suggested framework for the BR Report, disclosures in the template have broadly been classified under 5 parts, viz., section A, section B, section C, section D and section E.

Section A: General Information about the company

Basic details of the company: Corporate Identity Number (CIN) of the Company; Name of the Company; Registered address; Sector(s) that the Company is engaged in (industrial activity code-wise); Business locations; Markets served by the Company.

Section B: Financial Details of the company

Financial Aspects of the company: Paid up Capital; Total Turnover; Total Spending on Corporate Social Responsibility (CSR) as percentage of profit after tax (%); List of CSR activities undertaken by the company.

Section C: Information relating to Subsidiaries/ Supply chain associates

Participation of the subsidiary companies in BR initiatives of the parent company; Participation of supply chain associates in the BR initiatives of the company.

Section D: Business Responsibility Information

- Governance relating to business information;
- Details of Director/Directors responsible for BR;
- Details of principle wise (as per NVGs) adoption of policy/policies: in this context details relating to:
 - policy formulation in consultation with the relevant stakeholders;
 - policy conformance to any national /international standards;
 - policy approval by the board;
 - constitution of a specified committee of the Board/ Director/Official to oversee the implementation of the policy;
 - formal communication of policy to relevant internal and external stakeholders; grievance redressal mechanism related to the policy/policies;
 - independent audit/evaluation of the working of this policy by an internal or external agency, have all been given due weightage.

Section E: Principle wise performance is to be given in question answer format.

Principle 1: Businesses should conduct and govern themselves with Ethics, Transparency and Accountability

- Policy on ethics, bribery and corruption and its extension to associates;
- Stakeholders complaints and their redressal.

Principle 2: Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle

- Details relating to:
 - Products designed keeping environmental concerns in mind;
 - Resource usage in respect of above mentioned products;
 - Procurement of goods from surrounding areas and improving local capacity;
 - Mechanism to recycle products and waste.

Principle 3: Businesses should promote the well being of all employees

Details relating to:

- Total number of employees;
- Number of permanent women employees;
- Number of employees hired on temporary/contractual/casual basis;
- Employee association that is recognized by management;
- Number of complaints relating to child labour, forced labour, involuntary labour, sexual harassment in the last financial year.

Principle 4: Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized.

Details relating to:

- Identification of the disadvantaged, vulnerable & marginalized stakeholders;
- Special initiatives taken by the company to engage with the disadvantaged
- Vulnerable and marginalized stakeholders.

Principle 5: Businesses should respect and promote human rights details relating to:

- Policy of the company on human rights and its extension to associates;
- Stakeholders complaints and their redressal.

Principle 6: Business should respect, protect, and make efforts to restore the environment

Details relating to:

- Adoption of strategies/ initiatives to address global environmental issues such as climate change, global warming, etc by the company;
- Identify and assess potential environmental risks;
- Project related to Clean Development Mechanism;
- Initiatives on – clean technology, energy efficiency, renewable energy, etc;
- Number of show cause/ legal notices received from CPCB/SPCB;

Principle 7: Policy Advocacy

Details relating to:

Advocacy/lobbying, through associations/ chambers of which company is a member, for the advancement or improvement of public good, specifically in the broad areas of : Governance and Administration, Economic Reforms, Inclusive Development Policies, Energy security, Water, Food Security, Sustainable Business Principles.

Principle 8: Businesses should support inclusive growth and equitable development

Details relating to:

- specified programmes/initiatives/projects
- steps to ensure that this community development initiative is successfully adopted by the community

Principle 9: Businesses should engage with and provide value to their customers and consumers in a responsible manner

Details relating to:

- percentage of customer complaints/consumer cases are pending as on the end of financial year;
- 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.

(For detailed SEBI circular on Business Reporting, Students are advised to visit www.sebi.gov.in)

SEBI has issued 'Frequently Asked Questions' (FAQs) on 'Business Responsibility Reports' ("BR Reports") providing clarifications/ interpretations to various queries received on SEBI Circular dated August 13, 2012 on 'Business Responsibility Reports'. These FAQs are given at Annexure-I.

GLOBAL REPORTING INITIATIVE (GRI)

The Sustainability Reporting Guidelines developed by the Global Reporting Initiative (GRI), the Netherlands, is a significant system that integrates sustainability issues in to a frame of reporting.

What is GRI Network?

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.

What is the purpose of sustainability reporting?

Sustainability reporting is the practice of measuring, disclosing, and being accountable to internal and external stakeholders for organizational performance towards the goal of sustainable development.

A sustainability report should provide a balanced and reasonable representation of the sustainability performance of a reporting organization – including both positive and negative contributions.

What ever activities a company pursues in order to benefit all the stakeholders (community, suppliers, employees, and all having reasonable interest in the activities of the company).

What is GRI Reporting?

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 GRI Sustainability Reporting Guidelines offer Reporting Principles, Standard Disclosures and an Implementation Manual for the preparation of sustainability reports by organizations, regardless of their size, sector or location.

What are the G3.1 Guidelines?

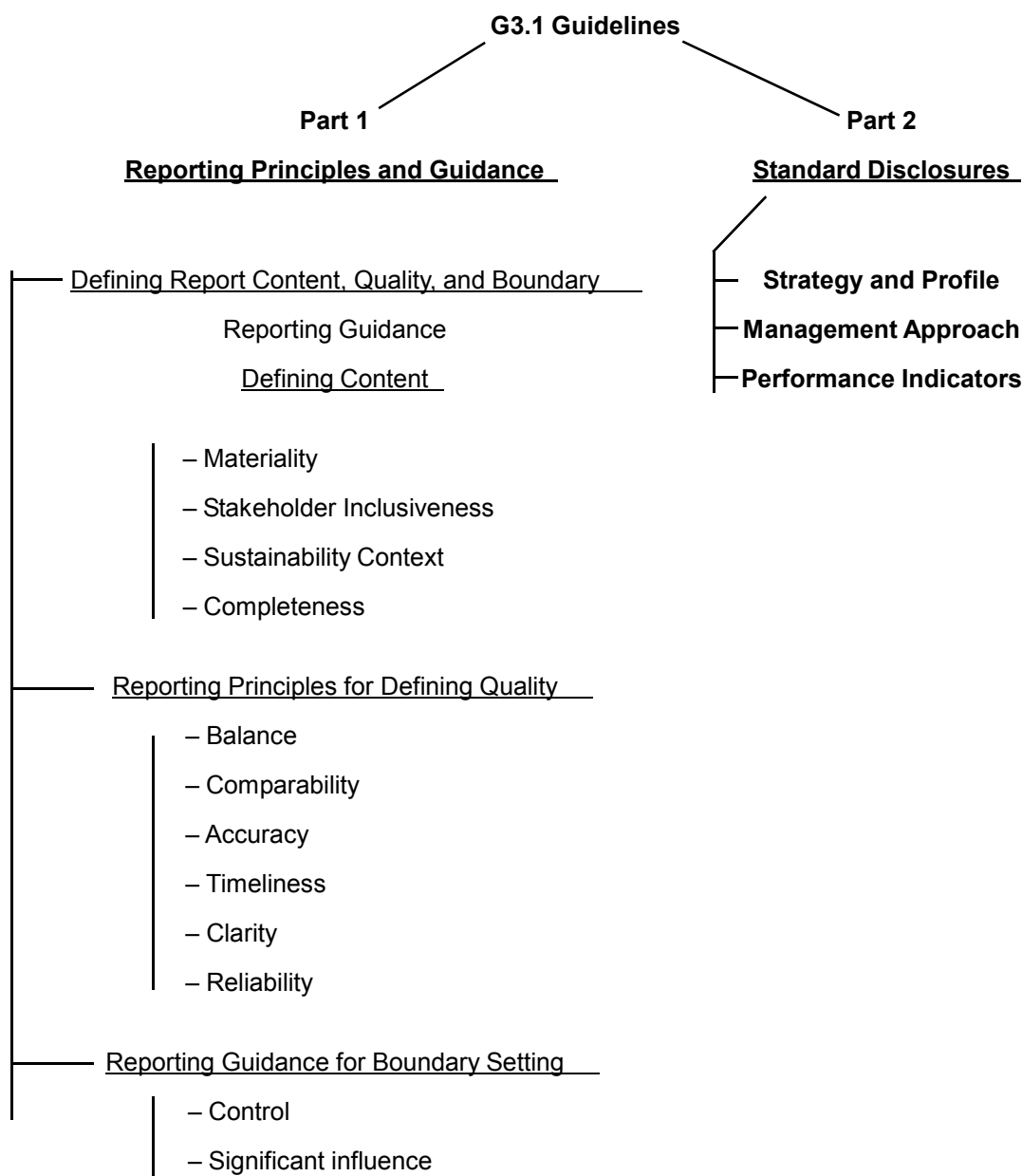
The Sustainability Reporting Guidelines are the cornerstone of the GRI Sustainability Reporting Framework. GRI recommends that every organization uses the Guidelines as the basis for their sustainability report. The Guidelines outline core content for reporting and are relevant to all organizations regardless of size, sector, or location. The GR1 Guidelines outline a disclosure framework that organizations can voluntarily, flexibly, and incrementally adopt.

The GRI Sustainability Reporting Framework is continuously being improved and expanded upon, as knowledge of sustainability issues evolve and the needs of report makers and users change.

Since the release, in 2006, of the third generation of the Guidelines - the G3 Guidelines, stakeholder feedback has suggested that more guidance and refinement is needed for certain fields. Based on this response, GRI initiated multi-stakeholder projects in the fields of Community Impacts, Gender, Human Rights and Content & Materiality for incremental updates of the framework, resulting in G3.1. It was launched on 23rd March, 2011. It includes expanded guidance for reporting on Human Rights, Local Community impacts and Gender.

The G3.1 Guidelines are divided into two parts:

- Reporting Principles and Reporting Guidance and
- Standard Disclosures (including performance indicators).



PART 1

Reporting Principles and Guidance

- Principles to define report **content**: materiality, stakeholder inclusiveness, sustainability context, and completeness.
- Principles to define report **quality**: balance, comparability, accuracy, timeliness, reliability, and clarity.
- Guidance on how to set the report **boundary**. “Reporting Boundary” enables reporting organizations to define the range of entities represented by the report. The Reporting Principles provide guidance to reporting organizations to help them contour the Report Boundaries.

1.1 Report Content

In defining the content of the report, the purpose is to achieve a balanced and reasonable presentation of the organisation’s performance. This determination should be made by considering both the organisation’s purpose and experience, and the reasonable expectations and interests of the organisation’s stakeholders.

The steps to use the GRI Reporting Framework are as follows:

1. Identify the topics and related indicators that are relevant by undergoing an interactive process using the Principles of materiality and stakeholder inclusiveness, sustainability context, and Report Boundaries.
2. When identifying the topics consider the relevance of all indicator aspects identified in the GRI Guidelines and applicable sector supplements.
3. From the set of relevant topics and indicators, use the tests listed for each Principle to assess which topics and indicators are material.
4. Use the Principles to prioritize selected topics and decide which will be emphasized.
5. The specific methods or processes used for assessing materiality be –
 - Differentiated for and identified by each organization.
 - Dependent on the guidance and tests found in the GRI Reporting Principles, and
 - Disclosed.

What is Materiality?

Definition: The information in a report should cover topics and indicators that reflect the organisation’s significant economic, environmental and social impacts or that which would substantially influence the assessments and decision of stakeholders.

Organizations are faced with a wide range of topics on which it could report. Relevant topics and Indicators are those that may reasonably be considered important for reflecting the organization’s economic, environmental, and social impacts, or influencing the decisions of stakeholders, and, therefore, potentially merit inclusion in the report. Materiality is the threshold at which an issue or Indicator becomes sufficiently important that it should be reported.

Materiality for sustainability reporting is not limited only to those sustainability topics that have significant financial impact on the organization. It also includes considering economic, environmental and social impacts that cross a threshold in affecting the ability to meet the needs of the present without compromising the needs of future generations.

A combination of internal and external factors should be used to determine whether information is material,

including factors such as the organisation's overall mission and competitive strategy, concerns expressed directly by stakeholders and the organisation's influence on upstream (e.g. customers) entities. Assessments of materiality should also take into account the basic expectations expressed in the international standards and agreements.

What is stakeholder inclusiveness?

Definition: The reporting organization should identify its stakeholders and explain in its report how it has responded to their reasonable expectations and interests.

Stakeholders are defined as entities or individuals that can reasonably be expected to be significantly affected by the organization's activities, products, and/or services; and whose actions can reasonably be expected to affect the ability of the organization to successfully implement its strategies and achieve its objectives. This included entities or individuals whose rights under law or international conventions provide them with legitimate claims vis-à-vis the organization.

Stakeholders can include those who are invested in the organization (e.g., employees, shareholders, suppliers) as well as those who are external to the organization (e.g., communities).

Since the stakeholders for an organization are scattered and there may be variation in their expectation and interest, stakeholder engagement processes can serve as tools for understanding the reasonable expectations and interests of stakeholders. Organizations typically initiate different types of stakeholder engagement as part of their regular activities, which can provide useful inputs for decisions on reporting.

The GRI guidance requires organization to document the stakeholder engagement processes. This will make the sustainability report assurable.

When stakeholder engagement processes are used for reporting purposes, they should be based on systematic or generally accepted approaches, methodologies, or principles. The overall approach should be sufficiently effective to ensure that stakeholders' information needs are properly understood. Failure to identify and engage with stakeholders is likely to result in reports that are not suitable, and therefore not fully credible, to all the stakeholders.

What is Sustainability Context?

Definition: The report should present the organization's performance in the wider context of sustainability.

The idea of sustainability reporting is that 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. This involves discussing the performance of the organization in the context of the limits and demands placed on environmental or social resources at the sectoral, local, regional or global level.

This concept is most articulate in the environmental arena in terms of the global limits on resource use and pollution levels. However, it can also be relevant with respect to social and economic objectives such as national or international socio-economic and sustainable developmental goals. For example, an organization could report on employee wages and social benefit levels in relation to nationwide minimum and medium income levels and the capacity of social safety nets to absorb those in poverty or those living close to the poverty line.

The organisation's own sustainability and business strategy policies provide the context in which to discuss performance. The relationship between sustainability and organizational strategy should be made clear as also the context within which performance is reported.

What is completeness?

Definition: Coverage of the material topics and Indicators and definition of the report boundary should be sufficient

352 PP-EGAS

to reflect significant economic, environmental, and social impacts and enable stakeholders to assess the reporting organization's performance in the reporting period.

Completeness primarily encompasses the dimensions of scope, boundary, and time.

'Scope' refers to the range of sustainability topics covered in a report. The sum of the topics and Indicators reported should be sufficient to reflect significant economic, environmental, and social impacts.

'Boundary' refers to the range of entities (e.g., subsidiaries, joint ventures, sub-contractors, etc.) whose performance is represented by the report.

'Time' refers to the need for the selected information to be complete for the time period specified by the report.

1.2 Reporting Principles for Defining Quality

This contains Principles that guide choices on ensuring the quality of reported information, including its proper presentation.

Balance

Definition: The report should reflect positive and negative aspects of the organization's performance to enable a reasoned assessment of overall performance.

The overall presentation of the report's content should provide an unbiased picture of the reporting organization's performance. The report should avoid selections, omissions, or presentation formats that are reasonably likely to unduly or inappropriately influence a decision or judgment by the report reader.

Comparability

Definition: Issues and information should be selected, compiled, and reported consistently. Reported information should be presented in a manner that enables stakeholders to analyze changes in the organization's performance over time, and 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 economic, environmental, and social performance against the organization's past performance, its objectives, and, to the degree possible, against the performance of other organizations.

Accuracy

Definition: The reported information should be sufficiently accurate and detailed for stakeholders to assess the reporting organization's performance.

Timeliness

Definition: Reporting occurs on a regular schedule and information is available in time for stakeholders to make informed decisions.

The timing of release refers both to the regularity of reporting as well as its proximity to the actual events described in the report.

Clarity

Definition: Information should be made available in a manner that is understandable and accessible to stakeholders using the report.

The report should present information in a way that is understandable, accessible, and usable by the organization's range of stakeholders (whether in print form or through other channels).

Reliability

Definition: Information and processes used in the preparation of a report should be gathered, recorded, compiled,

analyzed, and disclosed in a way that could be subject to examination and that establishes the quality and materiality of the information.

Stakeholders should have confidence that a report could be checked to establish the veracity of its contents and the extent to which it has appropriately applied Reporting Principles.

Reporting Boundary

A sustainability report should include in its boundary all entities that generate significant sustainability impacts (actual and potential) and/or all entities over which the reporting organization exercises control or significant influence with regard to financial and operating policies and practices.

For the purpose of setting boundaries, the following definitions should apply:

- **Control:** the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.
- **Significant influence:** the power to participate in the financial and operating policy decisions of the entity but not the power to control those policies.

PART 2 : Standard Disclosures

There are three different types of disclosures contained in this section.

- **Strategy and Profile:** Disclosures that set the overall context for understanding organizational performance and includes its strategy and analysis, profile, and governance, commitments & engagement.
- **Management Approach:** Disclosures that cover how an organization addresses a given set of topics in order to provide context for understanding performance in a specific area.
- **Performance Indicators:** Indicators that elicit comparable information on the economic, environmental, and social performance of the organization.

Further Developments

GRI- Next Generation G4 Guidelines

On May 22, 2013 GRI unveiled G4 Guidelines for Sustainability Reporting at its 2013 Global Conference on Sustainability and Reporting. The Guidelines are presented in two parts:

1. Reporting Principles and Standard Disclosures
2. Implementation Manual

The first part: Reporting Principles and Standard Disclosures contains Reporting Principles, Standard Disclosures, and the criteria to be applied by an organization to prepare its sustainability report 'in accordance' with the Guidelines. Definitions of key terms are also included.

The second part: Implementation Manual contains explanations of how to apply the Reporting Principles, how to prepare the information to be disclosed, and how to interpret the various concepts in the Guidelines.

TRANSITION TO G4 GUIDELINES

Reporting organizations using the G3 or G3.1 Guidelines will need to decide transition to the G4 Guidelines. GRI will continue to recognize reports based on the G3 and G3.1 Guidelines for up to two full reporting cycles. However, GRI indicates that reports published after 31 December 2015 should be prepared in accordance with the G4 Guidelines. GRI recommends that first time reporting organizations use the G4 Guidelines.

Features of GRI - G4 Guidelines

The G4 Guidelines have increased user friendliness and accessibility. Among other features, key enhancements in G4 include:

- up-to-date disclosures on governance, ethics and integrity, supply chain, anti-corruption and GHG emissions
- generic format for Disclosures on Management Approach
- GRI Content Index offering a transparent format to communicate external assurance
- Technically-reviewed content and clear disclosure requirements
- Detailed guidance on how to select material topics, and explain the boundaries of where material impacts occur
- Flexibility for preparers to choose the report focus
- Flexibility to combine with local and regional reporting requirements and frameworks
- Up-to-date harmonization and reference to all available and internationally-accepted reporting documents

What are the benefits of reporting?

For reporting organizations, the GRI Reporting Framework provides tools for: management, increased comparability and reduced costs of sustainability, brand and reputation enhancement, differentiation in the marketplace, protection from brand erosion resulting from the actions of suppliers or competitors, networking and communications.

For report users, the GRI Reporting Framework are a useful benchmarking tool, corporate governance tool and an avenue for long term dialogue with reporting organizations.

UN GLOBAL COMPACT

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 doing so, business, as a primary driver of globalization, can help ensure that markets, commerce, technology and finance advance in ways that benefit economies and societies everywhere.

The UN Global Compact presents a unique and powerful platform for participants to advance their commitments to sustainability and corporate citizenship. With over 10,000 corporate participants and other stakeholders from over 130 countries, it is the largest voluntary corporate responsibility initiative in the world.

UN Global Compact incorporates a transparency and accountability policy known as the Communication on Progress (COP). 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.

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:

Direct...	Indirect...
Global and local opportunities to dialogue and collaborate with other businesses, NGOs, labour, and governments on critical issues	Increased legitimacy and license to operate, particularly in the developing world, because business practices are based on universal values
Exchange of experiences and good practices inspiring practical solutions and strategies to challenging problems	Improved reputation and increasing brand value to consumers and investors – specifically in the context of changing societal expectations
Finding an entry-point through which companies can access the UN's broad knowledge of development issues	Increased employee morale and productivity, and attracting and retaining the highest qualified employees
Leveraging the UN's global reach and convening power with governments, business, civil society and other stakeholders	Improved operational efficiency, for instance through better use of raw materials and waste management
	Ensuring a company's accountability and transparency through a public communication on progress

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. (www.unglobalcompact.org)

CSR Reporting Frameworks

An important aspect of Corporate Social Responsibility (CSR) is the recognition that sound practices are often based on good standards of corporate governance. Good corporate governance provides the foundations of good Corporate Social Responsibility (CSR) by developing value-creating relationships with all stakeholders. It is therefore important that the stakeholders are shared with transparency the activities pursued by the Company in the Social Responsibility area.

MCA Voluntary Guidelines on Corporate Social Responsibility, 2009 provide that 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.

The following are some of the main standards for social, ethical and environmental reporting currently in use internationally:

The AA 1000 - framework developed by the Institute of Social and Ethical Accountability provides a standard for social and ethical accounting, auditing and reporting, including mandatory external verification and stakeholder engagement.

It aims to assist an organisation in the definition of goals and targets, the measurement of progress made against these targets, the auditing and reporting of performance and in the establishment of feedback mechanisms. This is done by

- Developing stakeholder engagement strategy - an integrated strategy for stakeholder engagement that strengthens both their relationships with stakeholders and their internal decision making processes.
- Facilitation of Stakeholder Dialogues - support through the planning, design, capacity building, facilitation and follow-up stages of stakeholder engagement to create processes that create change.
- Capacity building for stakeholder engagement - Engaging with stakeholders requires new skills and ways of thinking. through in-house training in stakeholder engagement, as well as ongoing mentoring support for leadership teams.

The Social Accountability - SA8000

SA8000 is one of the world's first auditable social certification standards for decent workplaces, across all industrial sectors. It is based on conventions of the ILO, UN and national law, and spans industry and corporate codes to create a common language to measure social compliance. The intent of SA8000 is to provide a standard based on international human rights norms and national labour laws that will protect and empower all personnel within a company's scope of control and influence, who produce products or provide services for that company, including personnel employed by the company itself, as well as by its suppliers/subcontractors, sub-suppliers, and home workers.

SA8000 covers the following areas of accountability:

- Child labor: No workers under the age of 15; minimum lowered to 14 for countries operating under the ILO Convention 138 developing-country exception; remediation of any child found to be working

- Forced labor: No forced labor, including prison or debt bondage labor; no lodging of deposits or identity papers by employers or outside recruiters
- Workplace safety and health: Provide a safe and healthy work environment; take steps to prevent injuries; regular health and safety worker training; system to detect threats to health and safety; access to bathrooms and potable water
- Freedom of Association and Right to Collective Bargaining: Respect the right to form and join trade unions and bargain collectively; where law prohibits these freedoms, facilitate parallel means of association and bargaining
- Discrimination: No discrimination based on race, caste, origin, religion, disability, gender, sexual orientation, union or political affiliation, or age; no sexual harassment
- Disciplinary practices: No corporal punishment, mental or physical coercion or verbal abuse
- Working hours: Comply with the applicable law but, in any event, not more than 48 hours per week with at least one day off for every seven day period; voluntary overtime paid at a premium rate and not to exceed 12 hours per week on a regular basis; overtime may be mandatory if part of a collective bargaining agreement
- Remuneration: Wages paid for a standard work week must meet the legal and industry standards and be sufficient to meet the basic need of workers and their families; no disciplinary deductions
- Management system for Human Resources: Facilities seeking to gain and maintain certification must go beyond simple compliance to integrate the standard into their management systems and practices.

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.

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.

The Good Corporation - global standard of corporate social responsibility developed by the Institute of Business Ethics. This covers fairness to employees, suppliers, customers and providers of finance; contributions to the community; and protection of the environment. Company performance is assessed annually by an independent verifier.

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.

358 PP-EGAS

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

(*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)

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

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.

Corporate Sustainability Assessment Criteria under the Dow-Jones Indices is as under:

<i>Dimension</i>	<i>Criteria</i>	<i>Weighting (%)</i>
Economic	Codes of Conduct / Compliance / Corruption & Bribery	5.5
	Corporate Governance	6.0
	Risk & Crisis Management	6.0
	Industry Specific Criteria	Depends on Industry
Environment	Environmental Performance (Eco-Efficiency)	7.0
	Environmental Reporting*	3.0
	Industry Specific Criteria	Depends on Industry
	Social	Corporate Citizenship/ Philanthropy
	Labour Practice Indicators	5.0
	Human Capital Development	5.5
	Social Reporting*	3.0
	Talent Attraction & Retention	5.5
	Industry Specific Criteria	Depends on Industry

Documents analyzed include:

- Sustainability reports
- Environmental reports
- Health and safety reports
- Social reports
- Annual financial reports
- Special reports (e.g. on intellectual capital management, corporate governance, R&D, employee relations)
- All other sources of company information; e.g. internal documentation, brochures and website.

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.

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.

BENEFITS OF SUSTAINABILITY REPORTING

Benefits of sustainability reporting are:

- Legitimation of corporate activities, products and services which create environmental and social impacts.
- Increase in corporate reputation and brand value.
- Gaining a competitive advantage.
- Comparison and benchmarking against competitors.
- Increasing transparency and accountability within the company.
- Establishing and supporting employee motivation as well as internal information and control processes.

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.

CONTEMPORARY DEVELOPMENTS- INTEGRATED REPORTING

Integrated Reporting is one step ahead of sustainability reporting and it's 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. This requirement is in effect for fiscal years starting on or after March 1, 2010. A guidance document was announced on January 25, 2011 by the South African Institute of Chartered accountants to assist South African companies in filing their integrated reports.

DEVELOPMENT OF SUCCESSFUL SUSTAINABILITY REPORT

Corporate sustainability reports are usually developed either by employees from the environment or sustainability department or from corporate communications unit or by external agency.

Reporting activity should be embedded in the general communication concept. Developing successful sustainability will in any case require a well managed team based process involving different departments or external communication agencies. Efforts should be focused on the systematization and consolidation of experiences which improve the knowledge.

SUSTAINABILITY REPORTING – CASE STUDIES

CASE STUDY I - TATA MOTORS LTD.

Tata Motors Limited is the leading automotive vehicle manufacturing company in India. Starting its drive to become India's largest automobile Company in the year 1945, the company has become the leading manufacturers in the commercial vehicle segment and is among the top three in passenger vehicles with winning products in the compact, midsize car and utility vehicle segments in India. Tata Motors is the world's fourth largest truck and bus manufacturer. It is the first Indian company under the engineering sector to be listed in the New York Stock Exchange in the year 2004.

Sustainability Reporting: The Sustainability Report 2010- 2011 entitled "Sustainability in Motion" is the Company's seventh Corporate Sustainability Report. Robust management systems, sound work ethics, better fuel efficiency standards, improved passenger safety, increased material recycling, conservation of energy and water, managing wastes, etc. are some of the examples of sustainability in motion at Tata Motors Limited.

Corporate Governance: Company has always adopted highest standards of professionalism, honesty, integrity and ethical behaviour, and incorporated them in the way of conducting business. The Company continues to strengthen its corporate governance practices through implementation of specific models and methods. The Tata Business Excellence Model (TBEM) is a means to drive business excellence and also track progress on long term strategic objectives.

Corporate Social Responsibilities: Company's CSR execution process comprises various activities like - identification of communities, prioritization of identified needs, designing projects for addressing selected needs, arrangement of resources and implementation of projects, evaluation of the impacts at the end of project. Health education employability and environment are the key areas of Company's CSR activities. The Tata Code of Conduct (TCoC) plays an important role in infusing the principles of ethics, transparency and responsibility across our operations.

Environment Management: The Company made an aim to create awareness and promote good environmental practices and management systems in its supply chain with the aid of ISO14001 certification for its channel partners. 'Yugandhara' is used for creating climate change consciousness amongst the employees. The Company focuses on tree plantation, wasteland development, encouraging usage of biogas plants, and rainwater harvesting initiatives. Overall the Company has invested 346.90 million towards environment management activities across operations. The notable initiatives briefly include:

- (i) 4.54% of total energy requirement of the Company was met through the Renewable energy, 48,620 tCO_{2e} emissions avoided through usage of renewable energy. 2.47% of net turnover was spent on R&D activities by Company.
- (ii) Company implemented ideas to reduce packaging material and increase use of recycled material as a result of the various programmes conducted, since the inception of this policy.
- (iii) Elimination of hazardous material as per regulations prescribed by the respective State Pollution Control Board (SPCB) and as per the Hazardous Wastes Management & Handling Rules and reducing their carbon footprint.
- (iv) Re-cycling of material is best illustrated in the use scrap metal generated externally as well as internally by either using sustainable packaging (replacing wood with metal) or reusing existing packaging (recycling wood).
- (v) Company works towards developing low carbon, fuel saving technologies that will help reduce greenhouse gas emissions. Development of CNG vehicles, electric vehicles and hybrids are at the forefront of company. CNG versions of buses and light commercial vehicles, LPG versions of Indica and CNG versions of ACE goods carrier are the one step towards it.

364 PP-EGAS

- (vi) Under the scheme of Green Infrastructure, a new technology of using light pipes as a source of light has been tried in Jamshedpur and planning to be implemented in Lucknow by the first quarter of FY 2011-12. A pilot solar power project of 25KW, is also set up by the Energy Management Cell to reduce the energy cost.
- (vii) Through coordination between NEAC (National Environment Awareness Campaign), GVK(Gram Vikas Kendra), and Tata Motors Jamshedpur the Company has been able to network with around 500 NGOs in the State of Jharkand highlighting the importance of bio-diversity conservation.

Water Conservation: The Company promotes recycling and reuse of water at all the plants, and also invest in developing systems for rain water harvesting. Two plants of company at Lucknow and Sanand are zero discharge plants. This has resulted in reduction of close to 70 percent in the groundwater consumption. 75,000 people and 30 villages have been benefited from Amrutdhara drinking water project for providing clean and safe water to the people.

Social Management: The Company has tremendously made its share in enhancing the standard of living by providing following benefits to employees and the society itself:

- (i) Company promotes employee well being during their tenure as well as after their retirement. Benefits such as gratuity, superannuation, Bhavishya Kalyan Yojana (BKY), post retirement medicare scheme, provident fund and compensated absences are provided to employees.
- (ii) Company has designed climate change mitigation and Sustainability programmes for creating awareness among Employees. Employees who showed aptitude for engineering and management excellence are sponsored for advanced technical / management programmes in reputed institutes.
- (iii) Safety observations and incidents receive a high priority in the company as top management being directly involved in all such matters. A steering committee is also headed by the Managing Director that addresses safety, health and environment issues on a monthly basis.
- (iv) Navjagrat Manav Samaj (NJMS), a registered society supported by Tata Motors Jamshedpur is part of the community services department, which is dedicated to the cause of identifying, treating and rehabilitating leprosy afflicted persons and their families.
- (v) Company has strict policy of not employing children in any of its Companies.

Assurance of Sustainability Report: The Sustainability Report is a fair representation of the company's sustainability-related strategies, management systems and performance. The Report, along with the referenced information in the annual report, meets the general contents and quality requirements of the GRI G3.1, and the external assurer confirms that the GRI requirements for Application Level 'A+' have been met. (www.tatamotors.com)

CASE STUDY II - ITC LIMITED

About the Company: ITC is one of India's largest multi-business corporate enterprises in the private sector. ITC began its journey from 1910 when the British owned Imperial Tobacco Company set foot in Calcutta. Today, with a market capitalisation of more than Rs.100,000 crores, portfolio of ITC includes- FMCG Businesses comprising Branded Packaged Foods, Personal Care Products, Education & Stationery Products, Lifestyle Retailing, Safety Matches and Incense Sticks.

Sustainability Reporting: Company's Sustainability Report is a transparent and voluntary disclosure of the Company's multidimensional Sustainability Initiatives. The Sustainability Report 2010-11 highlights following:

Corporate Governance Policy of ITC:

It includes Trusteeship - which means fulfilling the obligations to other stakeholders and protecting the rights of all Shareholders whether large or small.

Transparency - which means maximum appropriate disclosures without jeopardising the Company's strategic interests and internally, this means openness in the Company's relationship with its employees and in the conduct of its business. ITC believes transparency enhances accountability.

Empowerment – is a process of unleashing creativity and innovation throughout the organization by truly vesting decision-making powers at the most appropriate levels.

Control – ensures that freedom of management is exercised within a framework of checks and balances and is designed to prevent misuse of power.

Ethical Corporate Citizenship - means setting exemplary standards of ethical behaviour at all the levels relating to company.

Social Initiatives : In the social development category, ITC has made tremendous effort of global recognition as an example in sustainability practices – it is the only company in the world of its size to be carbon positive, water positive and solid waste recycling positive. This long and eventful travel across a century has been particularly meaningful and satisfying because it has enabled ITC to create over 5 million sustainable livelihoods. ITC's social development initiatives include-

- (i) Benefited over 4 million farmers in 40,000 villages through the e-Choupal rural digital infrastructure.
- (ii) Greened nearly 114,000 hectares of wastelands, by the Social and Farm Forestry programme, creating as a result, over 51 million person days of employment.
- (iii) Irrigated over 64,000 hectares of drylands, by its Watershed Development Initiative.
- (iv) Provided Animal Husbandry services to nearly 5,00,000 milch animals.
- (v) Created sustainable livelihoods for over 37,000 rural women.
- (vi) Benefited over 2,47,000 children through its Supplementary Education programme.
- (vii) Mission Sunehra Kal: Under this programme the Company has facilitated the following areas - Diversifying Farming Systems, as a strategy for climate change mitigation by broad-basing the farm-based livelihoods portfolio of the poor. Company's Projects implemented during 2009-10 stood at 66, spread across 51 districts of Andhra Pradesh, Tamil Nadu, Karnataka, Kerala, Orissa, West Bengal, Bihar, Madhya Pradesh, Maharashtra, Rajasthan and Uttar Pradesh. Together, these programmes reach out to more than 2.20 lakh households and over 1.20 million individuals who are directly benefited by the various interventions spread over 3787 villages. Initiatives have been spearheaded in five major areas:
 - e-Choupal
 - wasteland development
 - soil and moisture conservation
 - value-added crop rotation
 - animal husbandry programme

Environment Initiatives: 'Carbon positive', 'Water positive' and 'Waste recycling positive'. These path-breaking initiatives taken by Company have not only helped in demonstrating its leadership in responsible corporate stewardship, but have also enabled significant cost savings and nurtured the creation of environmental and societal capital, transforming the lives of many living at the margin. Company has made variety of contribution in this regard like-

- (i) ITC's farm and social forestry initiatives added 13,333 hectares of plantations during 2009-10. Total plantations, as on March 31, 2010 covered over 1,00,000 hectares. The social & farm forestry initiatives have not only contributed to a sustainable source of raw material for the Paperboards business, but also

helped sequester 4785 KT of CO₂, thus consolidating ITC's status as a 'Carbon Positive Company' for the fifth year in a row.

- (ii) Company has been working towards resource conservation, by minimising waste generation, maximising reuse & recycling of it. Company's 'WOW – Wealth out of Waste' programme has been instrumental in creating awareness amongst the public on the benefits of the 'Reduce-Reuse-Recycle' approach. This programme has contributed significantly to the protection of the environment, as well as in improving civic amenities, public health and hygiene.
- (iii) Company has an Integrated Watershed Development programme that spans nearly 65,000 hectares of waterstressed land. Watershed Catchment areas have been developed to reduce water consumption in company.
- (iv) The Paperboards and Specialty Papers business, which accounts for more than 91% of total waste generated in the company, has recycled over 99% of the total waste generated by its operations. This business has also recycled an additional 1,19,002 tonnes of externally sourced waste paper.
- (v) As a testament to these efforts, during the year under review, ITC Maurya in New Delhi became the first LEED – (Leadership in Energy and Environment Design) Platinum rated hotel worldwide in the existing building category. All ITC premium luxury Hotels are now LEED certified Green buildings with a Platinum rating.
- (vi) Many ITC units have achieved the goal of zero effluent discharge.

There are many other issues which are been concerned in ITC. From Health management to Human Rights or from prevention of insider trading to e-chaupal all are helping in attaining mission of company and directly or indirectly influencing all those who are relating to company.

Assurance of Sustainability Report: The Sustainability Report of ITC has been independently verified by M/s Ernst & Young and conforms to the stringent 'G3' guidelines of the Global Reporting Initiative (GRI) at the highest A+ level. The Report was also ranked 7th globally in 'best carbon disclosure' by the Corporate Responsibility Reporting Awards.

(Source: www.itcportal.com and Annual Report 2010-11)

CONCLUSION

In the light of the increasing and currently underestimated relevance of sustainability reporting for the reputation and social acceptance of a company, it can be expected that an increasing number of companies will be addressing this topic. Sustainability reporting is more than the publication of a report. It should be embedded in a comprehensive sustainability communication approach and in the company's general communication concept. In order to create corporate credibility, the sustainability reporting themselves has to be credible. This requires that the underlying corporate activities are not just for show but are systematically designed for the improvement of corporate sustainability.

Annexure-I

Business Responsibility Reports - Frequently Asked Questions (FAQs)

SEBI has, vide circular dated August 13, 2012, mandated inclusion of Business Responsibility Report (BRR) as a part of the Annual Report for top 100 listed entities. The said reporting requirement is in line with the 'National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (NVGs)' notified by Ministry of Corporate Affairs, Government of India, in July, 2011.

Listed below are Frequently Asked Questions (FAQs) regarding the aforesaid circular of SEBI on Business

Responsibility Reports. The FAQs have been developed in co-ordination with the Indian Institute of Corporate Affairs (IICA) to ensure that they are in line with the intent of NVGs.

1. What is Business Responsibility Report?

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' as a mandatory requirement for top 100 listed companies by SEBI's Circular dated August 13, 2012. Other companies are encouraged to use the Business Responsibility Report for making disclosures to their stakeholders. Business Responsibility Report must be submitted as a part of the Annual Report.

2. How does Business Responsibility Report help companies to make disclosures on adoption of responsible business practices or otherwise to the stakeholders?

A Business Responsibility Report 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.

3. How should a listed company, which is not among the top 100, report as per Business Responsibility Report?

The top 100 listed companies are mandatorily required to furnish the Business Responsibility Report to the Stock Exchange where they are listed and publish the report on their websites. Other listed companies are encouraged to follow guidelines and formats provided in SEBI's Circular by including the Business Responsibility Report in their Annual Report and publishing the same on the company's website.

4. Whether Business Responsibility Reporting applies to financial services company?

Business Responsibility Reporting is applicable to all types of companies including manufacturing, services etc. The principles of Business Responsibility Reporting are generic in nature and are applicable to all the companies.

5. How should the Business Responsibility Report be prepared by the holding and subsidiary companies where one of them is listed but may or may not be among the top 100?

The holding company and the subsidiary company are required to prepare separate Business Responsibility Reports. As stipulated in the Circular issued by SEBI, the requirement of including a Business responsibility Report is mandatory for the top 100 listed Companies. Thus, any Company, Holding or Subsidiary, which falls among the top 100 listed Companies, has to mandatorily furnish a Business Responsibility Report.

6. How does an MNC which has its subsidiary in India and which produces a single Global Reporting Initiative ("GRI") report, or an Indian listed company that already publishes a GRI report for its operations, report its Business Responsibility Report? Does it make a separate Business Responsibility Report or can it provide a linkage of the Business Responsibility Report to the GRI report?

In case of an MNC which has its subsidiary in India and which produces a single Global Reporting Initiative (“GRI”) report, the subsidiary is required to prepare its separate Business Responsibility Report highlighting the responsible business practices it has put in place in India.

In case of an Indian listed company that already publishes a GRI report for its operations, Clause 5 of the SEBI Circular says that those listed entities which have been submitting sustainability reports to overseas regulatory agencies/stakeholders based on internationally accepted reporting frameworks need not prepare a separate report for the purpose of these guidelines but only furnish the same to their stakeholders along with the details of the framework under which their Business Responsibility Report has been prepared and a mapping of the principles contained in these guidelines to the disclosures made in their sustainability reports. Sections D and E of the Business Responsibility Report provide the minimum set of questions on which such mapping must necessarily be done. Clauses A, B and C of the Business Responsibility Report contain generic questions which may easily be filled out by companies.

7. Is there any penalty, existing or proposed, if a company listed among top 100 companies on NSE or BSE fails to file a Business Responsibility Report?

SEBI views Business Responsibility Report as an enabling instrument for listed Companies to integrate Environmental, Social and Governance (“ESG”) parameters into their core business practices.

Failure to provide Business Responsibility Report will be construed as non-compliance with Clause-55 of Equity Listing Agreement. However, no particular level of compliance with NVG has been mandated.

8. Whether the Business Responsibility Report has to only cover the disclosure format contained in Annexure 1 of SEBI Circular No. CIR/CFD/DIL/8/2012 on “Business Responsibility Reports” dated August 13, 2012, or it also has to respond on the Principles contained in Annexure 2?

Companies are expected to disclose information on responsible business practices in accordance with formats specified in Annexure 1. Whereas, Annexure 2 details the principles to assess compliance with Environmental, Social and Governance norms which may be referred to while preparing information under Annexure 1.

Companies are free to furnish additional information which may not be covered under specific Business Responsibility Report questions but may be relevant for Business Responsibility reporting.

9. Can the Business Responsibility Report be in a format different from the one provided in the Circular?

The format has been provided to capture information in a comparable manner which is important to be adhered to. Companies are advised to follow the format so that the reports of various companies are comparable to each other. Companies may, however, add tables, graphs etc. to capture the data that enhance the quality of information.

10. Does Business Responsibility Report have to be a part of the annual report, or can it form a separate document with the flexibility to be released earlier or later than the annual report?

As per paragraph 5(a) of the SEBI Circular dated August 13, 2012, the requirement to include Business Responsibility Report as a part of the Annual Report is mandatory for top 100 listed Companies based on market capitalisation at BSE and NSE as on March 31, 2012. However, those listed Companies, which have been submitting sustainability reports to overseas regulatory agencies/stakeholders based on internationally accepted reporting frameworks, need not prepare a separate report for the purpose of the Circular but only have to furnish the same to their stakeholders along with the details of the framework under which their Business Responsibility Report has been prepared and a mapping of the principles contained in the SEBI Circular to the disclosures made in their sustainability reports.

In case the company is not providing full Business Responsibility Report and is providing only the mapping of BRR in Annual Report, it is expected to ensure that such mapping is carried out to the reports (which may be released earlier or later than the Annual Report) that are drawn over same reporting period.

Companies may provide full Business Responsibility Report as a part of their Annual Report or as a green initiative, host the Business Responsibility Report on their website and provide appropriate reference to the same in the Annual Report. Companies may also provide guidance on how a shareholder may request physical copy of the Business Responsibility Report from the company, if so desired.

If the company provides the Annual Report mentioning that company publishes the sustainability report under GRI framework along with a mapping as per the SEBI Circular and Clause 55 of Listing Agreement and indicates that the sustainability report would be available on its website providing website link for the same, it would be treated as sufficient compliance of the Clause 5(a) of the Circular dated August 13, 2012.

11. Does the Business Responsibility Report have to be submitted to any regulatory authorities, or only uploading on the company's own website is sufficient?

Business Responsibility Report has to be furnished to the Stock Exchange where it is listed in electronic format.

12. Principle 1: If a company's policy on bribery, ethics and corruption extends to some or all of the indicated entities, how should a company report?

The company may specify the list of entities to which the company's policy is applicable along with the Business Responsibility Report.

13. Principle 2: The Business Responsibility Report reporting format requires that a company lists and provides details of up to three products/services whose design is aligned with Principle 2; How does a company report if it does not have any such products or has less than three products that it can report on? How does a company report if it has more than three products that it can report on?

The Business Responsibility Report asks for "up to 3 of your products or services". Thus, three is only an upper limit. In case a company has less than three such products/services, it may report on the products/services it is having as on the date of reporting.

If the company has more than 3 products or services that can be reported, the company may report on top 3 products or services based on their contribution to company's turnover.

14. Principle 2: What is "sustainable sourcing"?

"Sustainable Sourcing" essentially refers to ensuring that a company's social and environmental performance extends to its supply chain. The company is expected to list all the activities that it is undertaking and processes it has established to encourage that its supply chain also embrace sustainability. More specifically:

- The report should indicate what proportion of its inputs (by quantity or value) are sourced from suppliers who are either covered by the company's sustainable sourcing programmes and/or are certified to be compliant with social and environmental standards such as SA 8000, ISO 14001, OHSAS 18001 or relevant labels like Rainforest Alliance, Rugmark, RSPO etc.
- Transportation refers to initiatives taken relating to transportation of inputs e.g. use of rail, use of CNG trucks, safety training of drivers (especially relevant to transportation of hazardous material) etc.

15. Principle 2: What is the meaning of "local" in reference to procurement of goods and services?

"Local" would mean sourcing from the nearest possible place where goods of comparable quality are available. This would mean, same village/ town/ state/ country as the context might require. Further, only the producer will be considered as source, and not wholesaler or retailer.

16. Principle 2: What is the meaning of “small” in reference to procurement of goods and services?

“Small” would typically mean one where the owner herself or himself is a worker and includes informal and/or producers such as self-help groups and home-based workers as well as producer-owned entities such as cooperatives, producer companies.

Apart from providers of goods, procurement of services such as landscaping, janitorial, security, taxis etc. may also be reported.

17. Principle 2: How does a company report on mechanisms to recycle products and waste? How does a company report on ‘percentage’ of recycling of products and waste?

The company has to describe what mechanism it has in place to recycle its products (including packaging) after consumption as well as for all wastes emerging out of its manufacturing process — solid, liquid and gas.

It has to report what percentage of its product & packaging are recyclable. It further has to report what percentage of waste produced is recycled. These percentages are to be calculated in terms of weight and not in terms of value.

18. Principle 4: How does a company identify “vulnerable and marginalized” stakeholders?

“Vulnerable and Marginalized” stakeholders may be defined as “Group of individuals who are unable to realize their rights or enjoy opportunities due to adverse physical, mental, social, economic, cultural, political, geographic or health circumstances”. These groups in India include the following:

- Women and girls
- People with disabilities
- Children
- Tribals
- Migrants, migrant workers

19. Principle 4: How does a company report if it has mapped all the stakeholders but has no formal mechanism to engage with them?

Companies are encouraged to set up and continually improve on mechanisms of engagement with the stakeholders in a systematic manner. The company can explain what steps it plans to take in making such continual improvements on any of the principles.

20. Principle 8: What is meant by impact assessment and how can a company do it?

Impact refers to measurable and sustainable change as a result of a company's programs/initiatives/projects. Ideally impact assessment methodologies establish a baseline and measure change against that.

21. Principle 8: What is meant by ‘successful adoption’ of the community development initiative by the community?

Community development initiative refers to a community taking initiative for development on any environmental, social or governance front.

Successful adoption means the extent of contribution of its resources, such as, human economic, know-how etc., towards ESG initiative.

22. Principle 9: Does a company need to report on cases decided or pending or filed in any of the judicial and quasi judicial authorities?

All cases filed have to be reported.

LESSON ROUND-UP

- Corporate sustainability is imperative for the long-term sustainable development of the economy and society.
- The term sustainability accounting is used to describe the new information management and accounting methods that aim to create and provide high quality information to support a corporation in its movement towards sustainability.
- Sustainability reporting describes new formalized means of communication which provides information about corporate sustainability.
- The Sustainability Reporting Guidelines developed by the Global Reporting Initiative (GRI), the Netherlands, is a significant system that integrates sustainability issues in to a frame of reporting.
- 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 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.
- 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.
- 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".
- 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.

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 the study lesson is to enable the students to have the awareness 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 Road Map
- 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 changes to 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 seemed to be responsible for the depletion of the ozone layer.

The Stockholm Conference laid framework for future environmental cooperation; led to the creation of global and regional environmental monitoring networks and the creation of the United Nations Environment Programme.

2. United Nations Environment Programme

United Nations Environment Programme (UNEP), established in 1972, is the voice for the environment within the United Nations system. UNEP acts as a catalyst, advocate, educator and facilitator to promote the wise use and sustainable development of the global environment. To accomplish this, UNEP works with a wide range of partners, including United Nations agencies, international organizations, national governments, non-governmental organizations, the private sector and civil society.

The Mission of the United Nation's Environment Programme is -

“To provide leadership and encourage partnership in caring for the environment by inspiring, informing, and enabling nations and peoples to improve their quality of life without compromising that of future generations.”

The major Milestones of the UNEP include:

- 1973 - Convention on International Trade in Endangered Species (CITES)
- 1985 - Vienna Convention for the Protection of the Ozone Layer
- 1987 - Montreal Protocol on Substances that Deplete the Ozone Layer
- 1988 - Intergovernmental Panel on Climate Change (IPCC)
- 1989 - Basel Convention on the Transboundary Movement of Hazardous Wastes
- 1992 - UN Conference on Environment and Development (Earth Summit) publishes Agenda 21, a blueprint for sustainable development

- 1992 - Convention on Biological Diversity
- 2000 - Malmö Declaration - first Global Ministerial Forum on the Environment calls for strengthened international environmental governance
- 2000 - Millennium Declaration - environmental sustainability 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

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 Chair Gro Harlem Brundtland, was convened by the United Nations in 1983. The Commission was created to address growing concern "about the accelerating deterioration of the human environment and natural resources and the consequences of that deterioration for economic and social development." In establishing the Commission, the UN General Assembly recognized that environmental problems were global in nature and determined that it was in the common interest of all nations to establish policies for sustainable development.

The Report of the Brundtland Commission, *Our Common Future*, published in 1987, deals with sustainable development and the change of policies needed for achieving that. The definition of this term in the report is quite well known and often cited:

"Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

4. United Nations Conference on Environment and Development

The United Nations Commission on Sustainable Development (CSD) was established by the UN General Assembly in December 1992 to ensure effective follow-up of United Nations Conference on Environment and Development (UNCED) (known as the Earth Summit) held in Rio De Janeiro. The following documents were the result 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 development that help society and the 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 national jurisdiction.
3. The right to development must be fulfilled so as to equitably meet developmental and environmental needs of present and future generations.
4. In order to achieve sustainable development, environmental protection shall constitute an integral part of the development process and cannot be considered in isolation from it.
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 standards of living and better meet the needs of the majority of the people of the world.
6. The special situation and needs of developing countries, particularly the least developed and those 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 scientific and technological knowledge, and by enhancing the development, adaptation, diffusion and transfer of technologies, including new and innovative technologies.
10. Environmental issues are best handled with participation of all concerned citizens, at the relevant level. At the national level, each individual shall have appropriate access to information concerning the environment that is held by public authorities, including information on hazardous materials and activities in their communities, 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, in particular developing countries.
12. States should cooperate to promote a supportive and open international economic system that would lead to economic growth and sustainable development in all countries, to better address the problems of environmental degradation. 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 produced 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 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, that 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 with under 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 that provided the traditional knowledge or biodiversity resources utilized).
- Access to and transfer of technology, including biotechnology, to the governments and/or local communities that provided 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. The Montreal Protocol on Substances that Deplete the Ozone Layer

It is a protocol to 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 co-operation. 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 the is to assist developing country parties to the Montreal Protocol 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 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 in 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 expires 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 to 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 was set up, called the Ad Hoc Working Group on Long-term Cooperative Action under the Convention (AWG-LCA).

To discuss future commitments for industrialized countries under the Kyoto Protocol, the Conference of the Parties serving as the Meeting of the Parties to the Kyoto Protocol established a working group in December 2005, called the Ad Hoc Working Group on further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP).

7. United Nations Conference on Sustainable Development, Rio+20

The United Nations Conference on Sustainable Development (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 and 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 current development agenda is centred on the Millennium Development Goals (MDGs). As the target date of the MDGs, 2015, is approaching, a debate on the framework of international development beyond 2015 has started. In this vein, 192 UN member states agreed at the Rio+20 summit to start a process of designing sustainable development goals, which are “action-oriented, concise and easy to communicate, limited in number, aspirational, global in nature and universally applicable to all countries while taking into account different national realities, capacities and levels of development and respecting national policies and priorities”.

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. It is thought that the SDGs will pick up where the Millennium Development Goals leave off and address criticism that the original Goals fail to address 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 developing global sustainable development goals to be 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 sustainable development goals for consideration and appropriate action.

Following are some commitments adopted under Rio+20 outcome document:

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 the 10th anniversary of the 2002 World Summit on Sustainable Development (WSSD) in Johannesburg.

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 recognize importance of addressing access of rural communities – including 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 - inclusive 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 will not be achieved in 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 cancers, 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 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 full and productive employment and decent work for all. Recognize importance of job creation. Workers should have access to education, skills and healthcare including occupational health and safety.

8. 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 activities, 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, the environmental problems are not confined to side effects of industrialisation but 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 provision of food, water, shelter and sanitation. The Indian Penal Code, 1860 contains penal provisions for corrupting or fouling the water or spring or reservoir so as to make it less fit for the purpose for which it is ordinarily used as well as for vitiating the atmosphere so as to make it noxious to the health of any person etc. In 1977, by 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 and to have compassion for living creatures.

The primary responsibility for administration and 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 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 must obtain clearance from Central and State Governments and also to obtain No Objection Certificate before 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 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 as 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 various measures nationally and by taking several important initiatives in the region.

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 under:
 - **The Water (Prevention and Control of Pollution) Act** was enacted in 1974 to provide for the prevention and control of water pollution, and for the maintaining or restoring of 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 to provide for damages to victims of an accident which occurs as a result of handling any 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 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 disposal of applications or appeals finally within 6 months of filing of the same. Initially, the NGT is proposed to be set up at five places of sittings and will 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 of 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 **Forest Conservation Act 1980** was enacted to help conserve the country's forests. It strictly restricts and regulates the de-reservation of forests or use of forest land for non-forest purposes without the prior approval of Central Government. To this end the Act lays down the pre-requisites for the diversion of forest land for non-forest purposes.
- The **Indian Forest Act, 1927** consolidates the law relating to forests, the transit of forest-produce and the duty leviable on timber and other forest-produce.
- 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 purposes of implementing the objects of the Act it establishes the National Biodiversity Authority in Chennai.

Apart from above 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

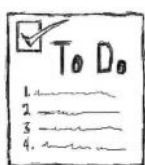
'Ecomark' in 1991 for easy identification of environment-friendly products. Any product which is made, used or disposed of in a way that significantly reduces the harm it would otherwise cause the environment could be considered as Environment-Friendly Product. The 'Ecomark' label is awarded to consumer 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, does not produce hazardous waste and consumes little energy in 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 environmental impacts
- Ultimately to improve the quality of the environment and to encourage the sustainable management of resources.



Enhance your
Knowledge

Go through the following:

1. <http://moef.nic.in>
2. <http://www.cpcb.nic.in/>
3. <http://unfccc.int/resource/docs/convkp/kpeng.html>
4. www.unglobalcompact.org/
5. www.unep.org
6. www.un-documents.net/wced-ocf.htm
7. www.unep.org/documents/default.asp?documentid=78
8. www.cbd.int/www.ilo.org/



LESSON ROUND-UP

- Environmentalists claims 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 United Nations Conference on Human Environment met at Stockholm in 1972. The conference called upon 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 the 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 was held in Rio De Janeiro.
- The documents that emerged of the Rio Summit – 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.
- The Rio Declaration on Environment and Development, often shortened to Rio Declaration, was a short document produced at the 1992 United Nations Conference on Environment and Development consisting 27 principles intended to guide future sustainable development around the world.
- 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 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 that was 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 expires 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 participation 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 protection of environment and 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 government. In the light of the statement discuss major initiative of Indian government and role of citizen of India.
4. Briefly explain about:
 - 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

INTRODUCTION

The rapid industrialization and competitiveness in industries has brought to the lime light the environmental issues in industries. The catastrophic accident in Bhopal in India in December 1984 and similar such accidents in other parts of the world in the past has 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 opting to violate the regulations and pay the penalty rather than conforming to them as they find the cost of conformity to be on the higher side.

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 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 do 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 that he had no 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 of 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 persons and caused widespread pollution to its 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. Livestock 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 providing the Government of India 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 in 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, if by reason of an accident occurring in such industry, persons die or are injured? Does the rule in *Rylands v. Fletcher* apply or is there any other principal on 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 this case came to the limelight after it 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 to a minimum the hazard to the workmen and the community living in the neighbourhood. These

questions raised by the petitioner being the questions of greatest importance particularly following the leakage of MIC gas from the Union Carbide Plant in Bhopal 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 having several units engaged in the manufacture of caustic soda, chlorine and various others 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, 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 the tank containing oleum gas as a result of the collapse of the structure on which it was mounted and it 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 and to remove such chemical and gases from the said place.

The Inspector of Factories and the Assistant Commissioner (Factories) issued separate orders on December 7 and 24, 1985 shutting down both 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 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, the caustic chlorine plant should be allowed to be restarted by the management subject to certain stringent conditions which were specified.

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 science of technology and it is not possible to totally eliminate such hazard or risk 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 were 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 and maximizing safety requirements in such industries.

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 become vulnerable to 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 inspirations 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 because such compensation must have a deterrent effect. The larger and more prosperous the enterprise, greater must be the amount of compensation payable by it for the harm caused on account of an accident in the 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 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. It cannot be therefore be said that the Supreme Court cannot

The Apex Court held that *the Rule laid down by Supreme Court in oleum gas leak case (AIR 1987 SC 1086), namely 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 in his activity is by far the more 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 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 the hazardous or inherently dangerous activity) alone has the resource 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 to him was foreseeable by the enterprise.

Water Pollution

Leather industry is one of the three major industries besides paper and textiles, consuming large quantities of water for 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 which when discharged as such will deplete 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 were produced before the Court as evidence.

In the case following the alarming details given by M.C. Mehta about the extent of pollution in the river Ganga due to the inflow of sewage from Kanpur only, the Court came down heavily on the Nagar Mahapalika (Municipality) and 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 ensue 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 of their working. After inspection, if it was found that the treatment plants are deficient in any respect or the deficiency pointed out earlier still continues, the Board will give reasonable time for the industries to cure 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 the industries will stop functioning there after.

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 Patancheru 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 Patancheru Environtech 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 with fatal consequences.

The Corporate Manslaughter and Corporate Homicide Act 2007 is a landmark in law. For the first time, companies and organisations can be found guilty of corporate manslaughter as a result of serious management failures resulting in a gross breach of a 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 in the management of health and safety result in a fatality.

Prosecutions will be of the corporate body and not individuals, but the liability of directors, board members or other individuals under health and safety law or general criminal law, will be unaffected. And the corporate body itself and individuals can still be prosecuted for separate health and safety offences.

Companies and organisations should keep their health and safety management systems under review, in particular, the way in which their activities are managed and organised by senior management.

PROSECUTION UNDER CORPORATE MANSLAUGHTER AND CORPORATE HOMICIDE ACT 2007

Cotswold Geotechnical Holdings Ltd., a geological survey company, in February' 2011 was fined with £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.

The prosecution was the first under the Corporate Manslaughter and Corporate Homicide Act 2007

CONCLUSION

To conclude, law has to grow in order to satisfy the needs of the fast changing society and keep abreast with the economic developments taking place in the country. As new situations arise, the law has to be evolved in order to meet the challenges of such new situations. Law cannot afford to remain static. We have to evolve new principles and lay down new norms which would adequately deal with the new problems which arise 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 a over all settlement of claims and awarded 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 with fatal consequences.
- Law cannot afford to remain static. We have to evolve new principles and lay down new norms which would adequately deal with the new problems which arise 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 *Ryland v. Fletcher*.
2. Discuss briefly about the Corporate Manslaughter and Corporate homicide Act, 2007 of the United Kingdom.

NOTE:

- The study has been prepared with some inputs adopted from Study Material of National Law School of India (NLSI) University Bangalore on Environmental Laws of MBL Course. The Institute acknowledges with thanks the NLSI.
- Students may refer to the relevant AIR mentioned in the study

**PROFESSIONAL PROGRAMME
ETHICS, GOVERNANCE AND SUSTAINABILITY**

PP-EGAS

TEST PAPERS

A Guide to CS Students

To enable the students in achieving their goal to become successful professionals, Institute has prepared a booklet "A Guide to CS Students" providing 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 from <http://www.icsi.edu/Portals/0/AGUIDETOCSSSTUDENTS.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 mark: 100

[Attempt all questions. Each question carries 1 mark. There is no negative mark for incorrect answers.]

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) Report on Corporate Governance 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 are the Steps to resolve the 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 about the '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 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)*

(Note: Answer one section from the above options)

3. (a) Briefly discuss about the Board Charter and 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 framework in Public Sector Enterprises. *(5 marks)*
4. (a) Board Committees are essential for the good management of an organization and to ensure the good governance as well. Discuss and list out the Board Committees prescribed under the Listing Agreement. *(5 marks)*

(b) Mr. X aged 20 years (Son of Mr. Q) is proposed to be appointed as an independent director on the Board of ABC Ltd., a listed company promoted by SUV Ltd. Mr. Q is an independent director on the Board of XYZ Ltd., which is also a listed company.

As a company secretary of ABC Ltd., examine the proposed appointment of Mr. X in the light of applicable provisions of clause 49 of the listing agreement and advise the board. (5 marks)

(c) Discuss the Board Composition prescribed for Nationalized Banks under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970. (5 marks)

PART B

(Sustainability)

(All Questions are Compulsory)

5. (a) Your Company is planning to bring out 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) Discuss in brief the National Voluntary Guidelines on Social, Environmental and Economical Responsibilities of Business issued by the Ministry of Corporate Affairs. (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 case the plea that reasonable care was taken while carrying out such activity is valid? Discuss in the light of decided case law. (5 marks)
- (b) What is the regulatory framework of 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)

(Note: Answer one section from the above options)

TEST PAPER 2

(This Test Paper is for recapitulate and practice for the students. Students need not to submit responses/ answers to this test paper to the Institute.)

Time allowed: 3 hours

Maximum marks: 100

PART A

(Ethics & Governance)

(All Questions are Compulsory)

1. (a) Ascertaining that trading by an insider was based on unpublished price sensitive information is a challenge. Explain with the help of a recent well reported case in the USA, the modus operandi adopted for carrying out illegal insider trading *(10 marks)*
(b) Explain briefly the following:
 - (i) Concept of whistle-blowing
 - (ii) Functions of ethics committee
 - (iii) Agency theory. *(5 marks each)*
2. (a) Discuss briefly the recommendations of the Committee set up by the SEBI which led to the inclusion of Clause 49 of the Listing Agreement. *(8 Marks)*
(b) Describe the role and responsibilities of a Chairman of the Board. *(7 Marks)*

OR

- (a) "Executive management can help the board govern more and manage less". Elucidate the statement. *(8 Marks)*
(b) Describe composition of the 'audit committee' and 'nomination and remuneration committee' as per clause 49 of the listing agreement. *(7 Marks)*
3. (a) The code of conduct of a company summarises its philosophy of doing business. The exact details of this code are a matter of discretion, but there are some common principles in drafting of the code in most of the companies. What are these principles? *(7 Marks)*
(b) Explain with the help of a case study, how investors can force ethical issues on the company's agenda. *(8 Marks)*
4. Write short notes on:
 - (a) Responsibility of Risk Management
 - (b) Stakeholder engagement
 - (c) Corporate Governance in public Sector Enterprises. *(5 marks each)*

PART B

(Sustainability)

(All Questions are Compulsory)

5. (a) Discuss in brief the principles recommended in the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business. *(5 marks)*
(b) Discuss briefly the relationship between sustainable development and corporate sustainability *(5 marks)*

- (c) What do you understand by the terms 'Green washing' and 'Greenhouse effect'? (5 marks)
6. (a) Describe the challenges involved in mainstreaming sustainability reporting. (7 marks)
- (b) Discuss in brief some of the commitments adopted under Rio+20 outcome document. (8 marks)

OR

- 6A. (a) Discuss in brief the concept of Kyosei. (5 marks)
- (b) "The reporting organisation should identify its stakeholders and explain in its sustainability reporting how it has responded to their reasonable expectations and interests." Elucidate this statement by considering stakeholders' inclusiveness. (5 marks)
- (c) State any five principles of Rio Declaration on Environment and Development. (5 marks)

