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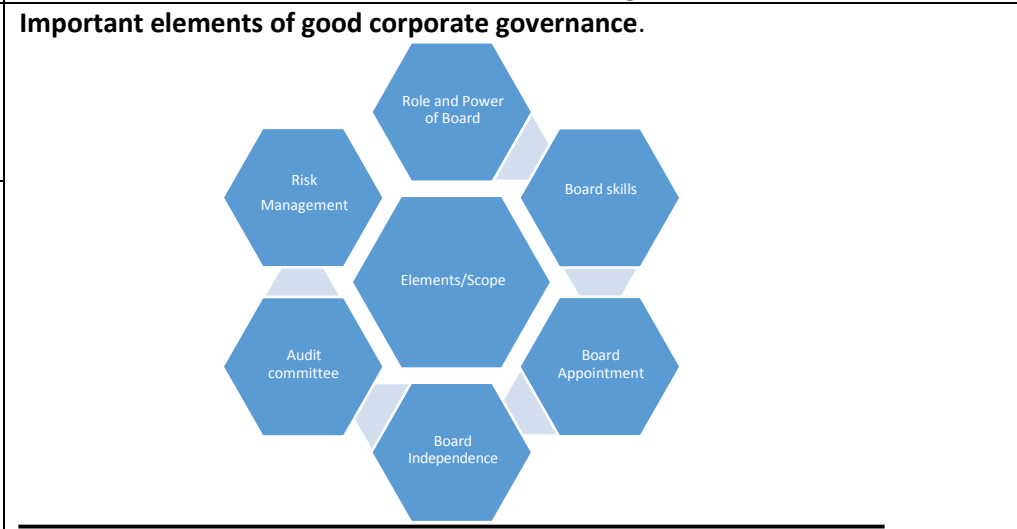
CHAPTER 1

Conceptual Framework of Corporate Governance

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| <p>MEANING AND DEFINITIONS OF CORPORATE GOVERNANCE</p> | <ul style="list-style-type: none"> ➤ The way by which a company is managed and organized to ensure that all the Financial Stakeholders (Including Shareholders and Creditors) receive their fair shares of the company Earnings and Assets. ➤ “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.” <p style="text-align: right;">The Institute of Company Secretaries of India</p> ➤ “Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.” <p style="text-align: right;">OECD Principles of Corporate Governance</p> |
| <p>Advantages of Corporate Governance</p> | <ul style="list-style-type: none"> ➤ Good corporate governance ensures corporate success and economic growth. ➤ There is a positive impact on the share price. ➤ It helps in brand formation and development. ➤ It ensures organization in managed in a manner that fits the best interests of all. ➤ It enhances Transparency, Accountability and Disclosure.(ADT) |
| <p>NEED FOR CORPORATE GOVERNANCE</p> | <p>Corporate Governance is needed to create a corporate culture of transparency, accountability and disclosure.(ADT)</p> <div style="text-align: center;">  </div> <p><u>Corporate Performance</u></p> <ul style="list-style-type: none"> • Improved governance structures and processes. • Ensure quality decision-making. • Enhance the long-term prosperity of companies. <p><u>Enhanced Investor Trust</u></p> <ul style="list-style-type: none"> • Investors who are provided with high levels of disclosure and transparency such as relating to data on matters such as pay governance, pay components, performance goals, and the rationale for pay decisions |

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| | <p>etc. are likely to invest openly in those companies.</p> <p><u>Better Access to Global Market</u></p> <ul style="list-style-type: none"> • Good corporate governance systems attract investment from global investors, which subsequently leads to greater efficiencies in the financial sector. • Even if corporations do not rely primarily on foreign sources of capital, adherence to good corporate governance practices helps improve the confidence of domestic investors, reduces the cost of capital, enables good functioning of financial markets and ultimately leads to more stable sources of finance. <p><u>Combating Corruption</u></p> <ul style="list-style-type: none"> • Corporate Governance enables a corporation to -compete more efficiently and prevent fraud and malpractices within the organization. <p><u>Easy Finance from Institutions</u></p> <ul style="list-style-type: none"> • Corporate Governance is needed as it 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. <p><u>Accountability</u></p> <ul style="list-style-type: none"> • Good Corporate Governance practices create the environment whereby Boards cannot ignore their accountability to these stakeholders. • The company is hence obliged to make timely disclosures on regular basis to all its shareholders in order to maintain good investor relation. |
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ELEMENTS / SCOPE OF GOOD CORPORATE GOVERNANCE



Role and power of Board
Directors are elected by shareholders or appointed by other board members and are tasked with making important decisions, such as corporate officer appointments, executive compensation and dividend policy.
The Board as a **main functionary is primary responsible to ensure value creation for its stakeholders.**
The 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.**

Board Skills
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.**

Board Appointment
The role of the board of directors was summarized by the **King Report** (a South

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| | <p>African report on corporate governance) as:</p> <ul style="list-style-type: none"> • to define the purpose of the company • to define the values by which the company will perform its daily duties • to identify the stakeholders relevant to the company . <p><u>Board Independence</u> Independent Board with sufficient independent directors is essential for sound corporate governance and would ensure that there are no actual or perceived conflicts of interest.</p> <p><u>Audit Committee</u> The Audit Committee is inter alia responsible for liaison with the management; internal and statutory auditors, reviewing the adequacy of internal control. The quality of Audit Committee significantly contributes to the governance of the company.</p> <p><u>Risk Management</u> 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.</p> |
| <p>Corporate Governance Theories.</p> | <p>Evolution of corporate governance:</p> <p>A. <u>Agency Theory</u> 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. 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.</p> <p>B. <u>Shareholders Theory/Stockholders Theory</u> 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. 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.</p> <p>C. <u>Stakeholders Theories</u> “Stakeholder Theory is an idea about how business really works. It says that for any business to be successful it has to create value for customers, suppliers, employees, communities and financiers, shareholders, banks and others people with the money”. Their interest has to go together in the same directions. According to this theory, the company is seen as an input-output model and from their point of view, a corporation exists for them and not the shareholders alone. Even the companies Act, 2013 provides various sections for the stakeholders such as:</p> <ul style="list-style-type: none"> • Section 135: Corporate Social Responsibility • Section 166(2): Duties of Directors • Schedule IV: Role and Function Of Independent Director • Regulation 4 of SEBI(LODR)Regulations 2018: Corporate Governance Principles. <p>D. <u>Stewardship Theories</u> The word ‘steward’ means a person who manages another’s property or estate.</p> |

Here, the word is used in the sense of **guardian in relation to a corporation**, this

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| | <p>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.</p> <ul style="list-style-type: none"> • First, of all values as standards are identified and formulated. • Second, step is to develop training programmes. • Thirdly, moral support is important to fill any gaps in values. |
| Management VS Ownership | <p>CONCEPT OF MANAGEMENT VS. OWNERSHIP</p> <p>The shareholders vest control of the business in the board of directors, who employ specialist management to run the business and return the profits of the business back to the shareholders.</p> <p>Company law's central dilemma has been the separation of ownership and control in companies.</p> <ul style="list-style-type: none"> ➤ On one side are shareholders, the ostensible owners; ➤ On the other side are corporate officers. <p>Shareholders own the company and hence the company ought to be work according to the dictates of the shareholders. However, it is not practically possible for each shareholder to participate in the decision making process on a day-to-day basis. Further shareholders generally cannot know and manage the full details of a corporation's business (nor do many wish to), they elect a board of directors to make broad corporate policy.</p> |
| Majority VS Minority | <p>CONCEPT OF MAJORITY RULE VS. MINORITY INTEREST.</p> <p>As a company is an artificial person with no physical existence, it functions through the instrumentality of the board of directors who is guided by the wishes of the majority.</p> <p>The rule of majority was established way back in 1843 in the case of Foss v. Harbottle.</p> |

Stages of development of Corporate Governance in USA

| <u>YEAR</u> | <u>DEVELOPMENT</u> |
|---|---|
| The Foreign Corrupt Practices Act, 1977 | Review of systems of internal control . |
| US Securities Exchange Commission, 1979 | Prescribed mandatory reporting on internal financial controls . |
| Treadway commission, 1985 | A proper control environment , desirability of constituting independent boards and its committees and objective internal audit function . |
| COSO issued Internal Control – Integrated Framework, 1992 | "To help businesses and other entities assess and enhance their internal control systems ". |
| Sarbanes – Oxley Act, 2002 | Enhanced financial disclosures and severe penalties for willful default by managers and auditors, in particular. |
| The Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010 | <p>The Dodd-Frank Act is a comprehensive and complex bill that contains 16 major areas of reform.</p> <p>Some of the main provisions found in the Dodd-Frank Act include:</p> <ol style="list-style-type: none"> I. Banks are required to come up with plans for a quick shutdown if they approach bankruptcy or run out of money. |

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| | <p>II. Financial institutions must increase the amount of money they hold in reserve to account for potential future slumps.</p> |
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Development of Corporate Governance in UK

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| 1992, Cadbury Report | <p>The committee in its report known as “Cadbury Report” recommended mainly:</p> <ul style="list-style-type: none"> ➤ Separation of role of CEO and Chairman of the Board. ➤ Balance composition of Board of directors with executive and non-executive directors. ➤ Selection process of Non-Executive Directors. ➤ Audit fees should be made public. |
| 1995 Greenbury Report | <p>The group submitted its Report in 1995, major findings were as under:</p> <ul style="list-style-type: none"> ➤ Constitution of Remuneration Committee comprising of Non Executive Directors. ➤ Responsibility of the committee in determining the remuneration of CEO and Executive Directors. ➤ Responsibility of the committee in determining the remuneration policy. |
| 1999 Turnbull Report | <p>A working group under the chairmanship of NIGEL TRUMBULL recommended the Internal Control Guidance for Directors on combined code.</p> |
| 2010 - 2012 Stewardship Code | <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.</p> |
| 2003 Higgs Report | <p>The resulting Report proposed that:</p> <ul style="list-style-type: none"> ➤ At least half of a board (excluding the Chair) be comprised of nonexecutive directors; ➤ That the non-executives should meet at least once a year in isolation to discuss company performance; ➤ That a senior independent director be nominated and made available for shareholders to express any concerns to; and ➤ That potential non-executive directors should satisfy themselves that they |

possess | the **knowledge, experience, skills and time to carry out their duties.**

U.S. Securities and Exchange Commission:

The aim of **U.S. Securities and Exchange Commission** is to **protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.** The SEC oversees the key participants in the securities world, **including securities exchanges, securities brokers and dealers, investment advisors, and mutual funds.**

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

Sarbanes-Oxley Act of 2002

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

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

- **SOX Section 302** – Corporate Responsibility for Financial Reports.
- **SOX Section 401:** Disclosures in Periodic Reports.
- **SOX Section 404:** Management Assessment of Internal Controls.

2018 UK Corporate Governance Code (2018 Code)

| Heading | Principles |
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| BOARD LEADERSHIP AND COMPANY PURPOSE | <ul style="list-style-type: none"> ➤ The board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture. ➤ In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties. |
| DIVISION OF RESPONSIBILITIES | <ul style="list-style-type: none"> ➤ The board should include an appropriate combination of executive and non-executive (and, in particular, independent non-executive) directors, such that no one individual or small group of individuals dominates the board’s decision-making. ➤ Non-executive directors should have sufficient time to meet their board responsibilities. |
| COMPOSITION, SUCCESSION AND EVALUATION | <ul style="list-style-type: none"> ➤ The board and its committees should have a combination of skills, experience and knowledge. ➤ Annual evaluation of the board should consider its composition, diversity and how effectively members work |

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| | together to achieve objectives. |
| AUDIT, RISK AND INTERNAL CONTROL | ➤ The board should present a fair, balanced and understandable assessment of the company's position and prospects. |
| REMUNERATION | <ul style="list-style-type: none"> ➤ Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. ➤ Directors should exercise independent judgement and discretion when authorising remuneration outcomes, taking account of company and individual performance, and wider circumstances. |

Corporate Governance Principles and Recommendations, Australia -2019

Central Principles

1. **Lay solid foundations for management and oversight:** A listed entity should clearly delineate the respective roles and responsibilities of its board and management and regularly review their performance.
2. **Structure the board to be effective and add value:** The board of a listed entity should be of an appropriate size and collectively have the skills, commitment and knowledge of the entity and the industry in which it operates, to enable it to discharge its duties effectively and to add value.
3. **Instil a culture of acting lawfully, ethically and responsibly:** A listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and responsibly.
4. **Safeguard the integrity of corporate reports:** A listed entity should have appropriate processes to verify the integrity of its corporate reports.
5. **Make timely and balanced disclosure:** A listed entity should make timely and balanced disclosure of all matters concerning it that a reasonable person would expect to have a material effect on the price or value of its securities.
6. **Respect the rights of security holders:** A listed entity should provide its security holders with appropriate information and facilities to allow them to exercise their rights as security holders effectively.
7. **Recognise and manage risk:** A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework.
8. **Remunerate fairly and responsibly:** A listed entity should pay director remuneration sufficient to attract and retain high quality directors and design its executive remuneration to attract, retain and motivate high quality senior executives and to align their interests with the creation of value for security holders and with the entity's values and risk appetite.

Code of Corporate Governance, Singapore - 2018

Principles

1. **The company is headed by an effective Board** which is collectively responsible and works with Management for the long-term success of the company.
2. The **Board has an appropriate level of independence and diversity** of thought and background in its composition to enable it to make decisions in the best interests of the company.
3. There is a clear division of responsibilities between the leadership of the Board and Management, and no one individual has **unfettered powers of decision-making**.

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

King IV Report on Corporate Governance, South Africa – 2016

Four reports have been issued by the King Committee since then –

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

| GOVERNANCE ELEMENT | PRINCIPLES |
|---|---|
| LEADERSHIP, ETHICS AND CORPORATE CITIZENSHIP | <ol style="list-style-type: none"> 1. The governing body should lead ethically and effectively. 2. The governing body should ensure that the organisation is and is seen to be a responsible corporate citizen. |
| STRATEGY, PERFORMANCE AND REPORTING | <ol style="list-style-type: none"> 3. The governing body should appreciate that the organisation’ score purpose, its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process. |
| GOVERNING STRUCTURES AND DELEGATION | <ol style="list-style-type: none"> 4. The governing body should serve as the focal point and custodian of corporate governance in the organisation. 5. The governing body should ensure that the appointment of, and delegation to, management contribute to role clarity and the effective exercise of authority and responsibilities. |

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| GOVERNANCE FUNCTIONAL AREAS | <p>6. The governing body should govern risk in a way that supports the organisation in setting and achieving its strategic objectives.</p> <p>7. The governing body should govern technology and information in a way that supports the organisation setting and achieving its strategic objectives.</p> |
| STAKEHOLDER RELATIONSHIPS | <p>8. The governing body of an institutional investor organisation should ensure that responsible investment is practiced by the organisation to promote the good governance and the creation of value by the companies in which it invests.</p> |

OECD PRINCIPLES OF CORPORATE GOVERNANCE

The Principles provide guidance through recommendations and annotations across six chapters.

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

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

- A. The **legal and regulatory requirements that affect corporate governance practices** should be consistent with the **rule of law, transparent and enforceable**.
- B. The division of responsibilities among different authorities should be clearly articulated and designed to serve the public interest.
- C. **Stock market regulation should support effective corporate governance**.
- D. **Cross-border co-operation** should be enhanced, including through **bilateral and multilateral arrangements** for exchange of information.

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

The corporate governance framework should **protect and facilitate the exercise of shareholders' rights and ensure the equitable treatment of all shareholders**, including **minority and foreign shareholders**.

All shareholders should have the opportunity to obtain effective redress for violation of their rights:

- A. Basic shareholder rights should include the right to:
 - secure methods of ownership registration;
 - convey or transfer shares;
 - **participate and vote in general shareholder meetings;**
 - **elect and remove members of the board; and**
 - **share in the profits of the corporation.**
- B. **Shareholders should be sufficiently informed** about, and have the right to approve or participate in, decisions concerning fundamental corporate changes such as:
 - **amendments to the statutes**, or articles of incorporation or similar governing documents of the company;
 - the **authorisation of additional shares;**
 - extraordinary transactions, including the transfer **of all or substantially all assets, that in effect result in the sale of the company.**
- C. Shareholders should have the **opportunity to participate effectively and vote in general shareholder meetings** and should be informed of the rules, including voting procedures, that govern general shareholder meetings:
 - Shareholders should be furnished with **sufficient and timely information** concerning the **date, location and agenda of general meetings**, as well as full and timely information regarding the issues to be decided at the meeting.

- Shareholders should have the **opportunity to ask questions to the board**, including questions relating to the annual external audit, to place items on the **agenda of general meetings**.
 - Effective shareholder participation in key corporate governance decisions, such as the **nomination and election of board members**, should be facilitated.
 - Impediments to cross border voting should be eliminated.
- D. Shareholders, including institutional shareholders**, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to **exceptions to prevent abuse**.
- E. All shareholders of the same series of a class should be treated equally.**
- Within any series of a class, all shares should carry the same rights. **All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase.**
 - The disclosure of capital structures and control arrangements should be required.
 - **Any changes in economic or voting rights** should be subject to **approval by those classes of shares which are negatively affected**.
- F. Related-party transactions** should be approved and conducted in a manner that ensures proper management of **conflict of interest and protects the interest of the company and its shareholders**.
- G. Minority shareholders should be protected from abusive actions** by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.
- H. Markets for corporate control** should be allowed to function in an efficient and transparent manner.
- **Anti-take-over devices** should not be used to shield **management and the board from accountability**.

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

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

- A. Votes should be cast by custodians or nominees** in line with the directions of the beneficial owner of the shares.
- B. 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.
- C. Insider trading and market manipulation should be prohibited and the applicable rules enforced.**
- D. Stock markets should provide fair and efficient price discovery** as a means to help promote effective corporate governance.

IV. The role of stakeholders in corporate governance:

- 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.** Mechanisms for employee participation should be permitted to develop.
- D.** The corporate governance framework should be complemented by an effective, **efficient insolvency framework and by effective enforcement of creditor rights**.

V. Disclosure and transparency:

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

- A. Disclosure should include:
 - The **financial and operating results of the company**.
 - Company objectives and **non-financial information**.
 - Major share ownership, including beneficial owners, and voting rights.
 - Remuneration of members of the board and key executives.
 - **Related party transactions**.
- B. Information should be prepared and disclosed in accordance with **high quality standards of accounting and financial and non-financial reporting**.
- C. An **annual audit** should be **conducted by an independent, competent and qualified, auditor** in accordance with **high-quality auditing standards** in order to provide the financial statements **fairly represent the financial position and performance** of the company.

VI. The responsibilities of the board:

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

- A. Board members should act on a **fully informed basis, in good faith, with due diligence** and care, and in the **best interest of the company and the shareholders**.
- B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.
- C. The board should **apply high ethical standards**. It should take into account the interests of stakeholders.
- D. The board should fulfil certain **key functions, including**:
 - **Selecting, compensating, monitoring** and, when necessary, **replacing key executives** and overseeing succession planning.
 - Ensuring a formal and transparent board nomination and election process.
 - Overseeing the **process of disclosure and communications**.
 - Monitoring the effectiveness of the company's governance practices and making changes as needed.
- E. The board should be able to exercise objective independent judgement on corporate affairs.
 - Board members should be able to commit themselves effectively to their responsibilities.
 - Boards should consider assigning a **sufficient number of nonexecutive board** members capable of exercising **independent judgement to tasks** where there is a potential for conflict of interest.
- F. In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.

Kautilya's fourfold duty of a king (Evidence of Corporate Governance from Arthashastra).

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| Raksha | Raksha - literally means protection , in the corporate scenario it can be equated with the risk management aspect. |
| Vridhhi | Vridhhi – literally means growth , in the present day context can be equated to stakeholder value enhancement |
| Palana | Palana – literally means maintenance/compliance , in the present day context it can be equated to compliance to the law in letter and spirit. |
| Yogakshema | Yogakshema – literally means well being and in Kautilya'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. |

CORPORATE GOVERNANCE – CONTEMPORARY DEVELOPMENTS IN INDIA

The initiatives taken by Government of India in 1991, aimed at economic **liberalization, privatization and globalization(LPG)** of the domestic economy.

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| 1999 Kumar Mangalam Birla Committee | <p>The Securities and Exchange Board of India (SEBI) had set up a Committee on May 7, 1999 under the Chairmanship of Kumar Mangalam Birla to promote and raise standards of corporate governance.</p> <p>The recommendations of the Report, led to inclusion of Clause 49 in the Listing Agreement in the year 2000.</p> |
| 2002 Naresh Chandra Committee | <p>Due to the various scams in US like WORLD COM etc. and the enactment of Sarbanes Oxley Act in USA the Indian government wake up and constituted a committee under a chairmanship of Naresh Chandra. Naresh Chandra committee was appointed to examine and recommend about the ROLE OF INDEPENDENT DIRECTORS. SERVICES NOT TO BE PERFORMED BY STATUTORY AUDITOR(SEC.144).</p> |
| 2003 N. R. Narayana Murthy Committee | <p>SEBI 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.</p> |
| 2004 Dr. J. J. Irani Committee on Company Law | <p>The Government constituted a committee under the Chairmanship of Dr. J. J. Irani 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.</p> |
| 2013 Companies Act | <p>The Companies Act, 2013 envisaged radical changes in the sphere of Corporate Governance in India. The Companies (Amendment) Act, 2017 consisting of 93 amendments to the 2013 Companies Act, further resulted in changes related to legal definitions (related party, subsidiary company, associate company, independent directors, etc.) corporate governance, (eg. Ratification of auditors appointment and role of audit committee) and management compliance.</p> <p>Some of the Provisions of Companies Act, 2013 related to Corporate Governance are:</p> <ul style="list-style-type: none"> ➤ Appointment and maximum tenure of Independent Directors; ➤ Appointment of Woman Director; ➤ Appointment of Whole time Key Managerial Personnel; ➤ Performance Evaluation of the Directors |

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| | <ul style="list-style-type: none"> ➤ and Committee & Board as a whole; ➤ Separation of role of Chairperson and Chief Executive Officer; ➤ Mandatory provisions regarding vigil mechanism; ➤ Constitution of CSR Committee; ➤ Secretarial Audit; ➤ Rotation of Auditors; ➤ Constitution of NFRA. |
| <p>2015 SEBI (Listing Obligations and Disclosure Requirements) Regulations (REFER SEBI LODR NOTES)</p> | <p>The provisions pertaining to listed entities with the Companies Act, 2013, the SEBI notified SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 for the listed entities having listed designated securities on recognized stock exchanges.</p> |
| <p>2017 Uday Kotak Committee</p> | <p>The SEBI Committee on corporate governance was formed in June 2017 under the Chairmanship of Mr.Uday Kotak with the aim of improving standards of corporate governance of listed companies in India.</p> <p>The Committee was requested to make recommendations to SEBI on the following issues:</p> <ul style="list-style-type: none"> ➤ Ensuring independence in spirit of Independent Directors and their active participation in functioning of the company; ➤ Improving safeguards and disclosures pertaining to Related Party Transactions; ➤ Issues in accounting and auditing practices by listed companies; ➤ Improving effectiveness of Board Evaluation practices; ➤ Addressing issues faced by investors on voting and participation in general meetings; Disclosure and transparency related issues, if any; ➤ Any other matter, as the Committee deems fit. <p>The Committee submitted its report to SEBI in October 2017.</p> <ul style="list-style-type: none"> ➤ Composition and Role of the Board of Directors; ➤ Institution of Independent Directors; ➤ Board Committees; ➤ Disclosures and Transparency; ➤ Accounting and Audited related Issues; ➤ Investors participation in Meetings of Listed Entities; ➤ Governance aspects of Public Sector Enterprises. <p>In its board meeting on March 27, 2018, SEBI, after detailed consideration and due deliberation, accepted several recommendations of the Kotak Committee without any modifications and</p> |

accepted a few other recommendations with certain modifications as to timelines for implementation, applicability thresholds among others. Some of the **major changes accepted relate to:**

- Increasing Transparency -Enhanced Disclosure Requirements;
- Disclosure of Expertise/Skills of Directors;
- Enhanced Disclosure of Related Party Transactions (RPT);
- Mandatory Disclosure of Consolidated Quarterly Results with effect from Financial Year 2019-2020;
- Enhanced Quorum;
- Capping the Maximum Number of Directorships;
- Expanded Eligibility Criteria for Independent Directors;
- Enhanced Role of committees;
- Down-streaming Corporate Governance;
- Secretarial Audit to be Mandatory for Listed Entities and their Material Unlisted Subsidiaries.

SOME EXAMINATION QUESTIONS

1. Good Governance is integral to the very existence of a company-Explain.
2. What are the elements of Good Corporate Governance?
3. What are the basic theories of that led to the evolution of concept of the Corporate Governance?
4. Discuss in brief the development of the concept of Corporate Governance in U.K.
5. Discuss briefly the Corporate Governance developments in India.
6. Briefly explain OECD principles of Corporate Governance.
7. What are Kautilya's fourfold duty of a king? **Or** Evidence of CG from Arthashastra.
8. ICSI principles of Corporate Governance, inter alia, include sustainable development of all stakeholders and adherence to ethical standers. COMMENT
9. How has the SEBI contributes in improving CG Standards in India?
10. Write a short note on:
 - U.S. Securities and Exchange Commission
 - Sarbanes-Oxley Act of 2002

CHAPTER 2

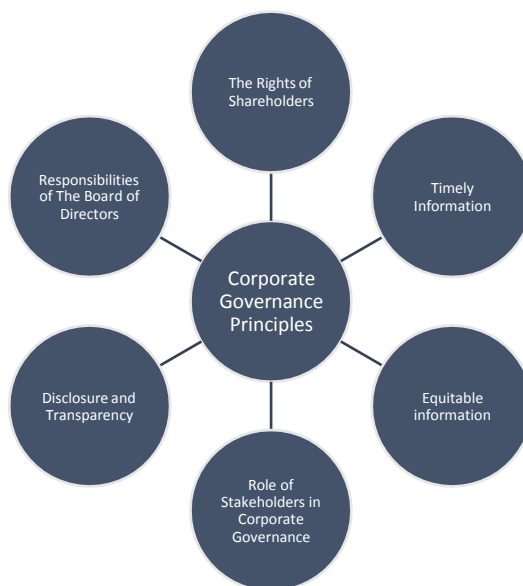
Legislative Framework of Corporate Governance in India

PRINCIPLES FOR PERIODIC DISCLOSURES AND FOR CORPORATE GOVERNANCE

Regulation 4 of the SEBI (LODR) Regulations, 2015 provides for broad

- Principles for periodic disclosures and
- Corporate governance by listed entities.

- A. **Principles for Periodic Disclosures:** The listed entity which has listed securities shall make **disclosures and abide by its obligations under these regulations**, in accordance with the following principles:
- a. Information shall be **prepared and disclosed in accordance with applicable standards of accounting and financial disclosure**.
 - b. The listed entity shall **refrain from misrepresentation and ensure that the information provided to recognised stock exchange(s) and investors is not misleading**.
 - c. The listed entity shall provide **adequate and timely information** to recognised stock exchange(s) and investors.
 - d. **Filings, reports, statements, documents and information** which are event based or are **filed periodically shall contain relevant information**.
 - e. **Periodic filings, reports, statements, documents and information** reports shall **contain information that shall enable investors to track the performance** of a listed entity over regular intervals of time and shall provide **sufficient information to enable investors to assess the current status of a listed entity**.
- B. **Corporate Governance Principles :** The listed entity which has listed its specified securities shall comply with the **corporate governance principles under following broad headings-** :



- a. **The rights of shareholders :** The listed entity shall seek to protect and facilitate the exercise of the following rights of shareholders:
- **Right to participate** in, and to be **sufficiently informed** of, decisions concerning fundamental corporate changes.
 - **Opportunity to participate effectively and vote in general shareholder meetings.**
 - **Opportunity to ask questions** to the board of directors, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.
 - **Exercise of ownership rights by all shareholders**, including institutional investors.
 - Adequate mechanism to address the grievances of the shareholders.
 - **Protection of minority shareholders.**
- b. **Timely information:** The listed entity shall provide adequate and timely information to shareholders, including but not limited to the following:
- **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.
- c. **Equitable treatment:** The listed entity shall ensure equitable treatment of all shareholders, **including minority and foreign shareholders**, in the following manner:
- All shareholders of the **same series of a class shall be treated equally.**
 - Exercise of **voting rights by foreign shareholders shall be facilitated.**
 - The listed entity shall devise a framework to **avoid insider trading and abusive self-dealing.**
- d. **Role of stakeholders in corporate governance:** The listed entity shall recognise the rights of its stakeholders and encourage co-operation between listed entity and the stakeholders, in the following manner:
- Stakeholders shall have the **opportunity to obtain effective redress for violation of their rights.**
 - The listed entity shall devise an effective **whistle blower mechanism** enabling stakeholders, including individual employees and their representative bodies, **to freely communicate their concerns about illegal or unethical practices.**
- e. **Disclosure and transparency:** The listed entity shall ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the listed entity, in the following manner:
- Information shall be **prepared and disclosed in accordance** with the prescribed standards of **accounting, financial and non-financial disclosure.**
 - **Minutes of the meeting** shall be maintained explicitly recording **dissenting opinions, if any.**
- f. **Responsibilities of the board of directors:** The board of directors of the listed entity shall have the following responsibilities:
- i. **Disclosure of information:**
 - Members of board of directors and key managerial personnel shall disclose to the board of directors whether they, directly, indirectly, or on behalf of third

parties, have a **material interest in any transaction** or matter directly affecting the listed entity.

- The board of directors and senior management **shall maintaining confidentiality of information** in order to foster a culture of good decisionmaking.

ii. Key functions of the board of directors :

- Monitoring the effectiveness of the listed entity's governance practices and making changes as needed.
- **Selecting, compensating, monitoring** and, when necessary, replacing **key managerial personnel** and overseeing succession planning.
- Monitoring and managing **potential conflicts of interest of management**, members of the board of directors and shareholders, including misuse of corporate assets and abuse in related party transactions.
- Overseeing the process of disclosure and communications.
- Monitoring and reviewing board of director's evaluation framework.

iii. Other responsibilities:

- The board of directors shall provide strategic guidance to the listed entity, ensure **effective monitoring of the management** and shall be **accountable to the listed entity** and the **shareholders**.
- The board of directors shall set **a corporate culture**.
- Members of the board of directors shall act on a fully informed basis, in **good faith, with due diligence and care**, and in the best interest of the listed entity and the shareholders.
- The board of directors shall encourage continuing directors training to ensure that the members of board of directors are kept up to date.
- The board of directors shall **maintain high ethical standards**.
- The board of directors shall exercise **objective independent judgement** on corporate affairs.
- When committees of the board of directors are established, their **mandate, composition and working procedures** shall be well defined and disclosed by the board of directors.
- In order to fulfil their **responsibilities, members of the board of directors** shall have access to **accurate, relevant and timely information**.

CORPORATE GOVERNANCE OF BANKING AND FINANCIAL INSTITUTIONS

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

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

- The major law relating to the banking is governed by the **Banking Regulation Act 1949**.
- The State Bank of India is governed by the **State Bank of India Act, 1955**.

- Nationalized banks are governed by the **Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.**
- The private sector banks came into being as company registered **under the Companies Act (whether under the Companies Act, 2013/1956 or under the Indian Companies Act, 1913 or prior to that).**
- The banks listed with the stock exchange have to adhere to the requirement of the **SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2018.**
- Additionally **Foreign Exchange Management Act (FEMA), 1999, Payment and Settlement Systems Act, 2007** and other directives/ regulations/ guidelines/ instructions issued **by RBI and SEBI** from time to time have created a positive environment and future scope for enhancing corporate governance.

Ganguly Committee Recommendations on Corporate Governance in Banks

The list of the recommendations is as under:

Recommendations which may be implemented by all banks:

I. Responsibilities of the Board of Directors:

- a. A strong corporate board should fulfil the following four major roles:
 - **Overseeing the risk profile of the bank,**
 - **Monitoring the integrity of its business and control mechanisms,**
 - **Ensuring the expert management, and**
 - **Maximising the interests of its stakeholders.**
- b. The Board of Directors should ensure that responsibilities of directors are well defined and every director should be familiarised on the functioning of the bank before his induction, covering the following essential areas:
 - **Delegation of powers to various authorities by the Board,**
 - **Strategic plan of the institution;**
 - **Organisational structure;**
 - **Financial and other controls and systems;**
 - **Economic features of the market and competitive environment.**

II. Role and responsibility of independent and non-executive directors:

- a. The independent/non-executive directors have a **prominent role in inducting** and sustaining a **proactive governance framework in banks.**
- b. It would be desirable for the banks to take an undertaking from each independent and nonexecutive director to the effect that he/she has gone through the guidelines defining the role and responsibilities and enter into covenant to **discharge his/her responsibilities to the best of their abilities, individually and collectively.**

III. Training facilities for directors:

- a. While RBI can offer certain training programmes/seminars in this regard at its training establishments, large banks may conduct such **programmes in their own training centres.**
- b. Need-based training programmes/seminars/ workshops may be designed by banks and participation in such **programmes could make the directors more sensitive to their role.**

IV. Agenda and minutes of the board meeting:

- a. The **draft minutes of the meeting** should be forwarded to the directors, preferably via the **electronic media, within 48 hours of the meeting** and ratification obtained from the directors within a definite time frame.

- b. The Board should **review the status of the action** taken on points arising from the earlier meetings till action is completed to the satisfaction of the Board, and any pending item **should be continued to be put up as part of the agenda items before the Board.**

V. Committees of the Board:

- a. **Shareholders' Redressal Committee:** As communicated to banks vide circular DBOD No.111/08.138.001/2001-02 dated June 4, 2002 on SEBI Committee on Corporate Governance, the banks which have issued shares,/debentures to public may form a committee **under the chairmanship of a non-executive director to look into redressal of shareholders' complaints.**
- b. **Risk Management Committee:** In pursuance of the Risk Management Guidelines issued by the Reserve Bank of India in October 1999, **every banking organisation is required to set up Risk Management Committee.** The formation and operationalisation of such committee should be speeded up and their role further strengthened.
- c. **Supervisory Committee:** The role and responsibilities of the Supervisory Committee as envisaged by the Group viz.,
 - **Monitoring of the exposures (both credit and investment) of the bank,**
 - **Review of the adequacy of the risk management process and**
 - **Upgradation thereof, internal control system, ensuring compliance with the statutory/regulatory framework etc., may be assigned to the Management Committee/Executive Committee of the Board.**

VI Disclosure and transparency: The following disclosures should be made by banks to the Board of Directors at regular intervals as may be prescribed by the Board in this regard:

- Progress made in putting in place a progressive risk management system, and risk management policy and strategy followed by the bank.
- Conformity with corporate governance standards viz. in composition of various committees, their **role and functions, periodicity of the meetings and compliance** with coverage and review functions etc.

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| Recommendations applicable only to public sector bank |
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- 1. **Information flow:** In order to improve manner in which the proceedings are recorded and followed up in public sector banks, they may initiate measures to provide the following information to the board:
 - A **summary of key observations** made by the directors which should be **submitted in the next board meeting.**
 - A more **detailed recording of the proceedings** which will clearly bring out the **observations, dissents**, etc. by the individual directors which could be forwarded to them for their confirmation.
- 2. **Company Secretary:** The Company Secretary has important fiduciary and Company Law responsibilities. The Company Secretary is the nodal point for the Board to get feedback on the status of compliance by the organisation in regard to **provisions of the Company Law, listing agreements, SEBI regulations, shareholder grievances, etc.** In view of the important role performed by the Company Secretary vis-à-vis the **functioning of the Boards of the banks**, as also in the context of some of the public sector banks having made public issue it may be necessary to have Company Secretary for these banks also. Banks

should therefore consider appointing qualified Company Secretary as the Secretary to the Board and have a Compliance Officer (**reporting to the Secretary**) for ensuring compliance with various regulatory/ accounting requirements.

Recommendations applicable only to private sector bank

1. Eligibility criteria and 'fit and proper' norms for nomination of directors:

- a. The Board of Directors of the banks while nominating/ co-opting directors should be guided by certain broad 'fit and proper' norms for directors, viz. formal qualification, experience, track record, integrity etc. The Board of Directors may, therefore, evolve appropriate systems for ensuring 'fit and proper' norms for directors, which may include calling for information by way of self-declaration, verification reports from market, etc.
- b. The following criteria, which is in vogue in respect of nomination to the boards of public sector banks, may also be followed for nominating independent/ non-executive directors on private sector banks:
 - **The candidate should normally be a graduate (which can be relaxed while selecting directors for the categories of farmers, depositors, artisans, etc.)**
 - **He/she should be between 35 and 65 years of age.**
 - **He/she should not be a Member of Parliament/Member of Legislative Assembly/ Member of Legislative Council.**

2. Commonality of directors of banks and non banking finance companies (NBFC):

In case, a director on the board of an NBFC is to be considered for appointment as director on the board of the bank, the following conditions must be followed:

- **He/she is not the owner of the NBFC, [i.e., share holdings (single or jointly with relatives, associates, etc.) should not exceed 50%];**
- **He/she is not related to the promoter of the NBFC;**
- **He/she is not a full-time employee in the NBFC;**
- **The concerned NBFC is not a borrower of the bank.**

3. Composition of the Board:

In the context of banking becoming more complex and competitive, the composition of the Board should be commensurate with the business needs of the banks. There is an urgent need for making the Boards of banks more contemporarily professional by inducting technical and specially qualified personnel.

Basel Committee on Corporate Governance

Basel Committee on Banking Supervision (BCBS) released Guidelines on Corporate Governance for banks were released by the Basel Committee on Banking Supervision in July 2015.

The principles of corporate governance of these guidelines are as under:

- **Principle 1: Board's overall responsibilities:** The board has overall responsibility for the bank, including approving and overseeing the implementation of the bank's strategic objectives, governance framework and corporate culture. The board is also responsible for providing oversight of senior management.
- **Principle 2: Board qualifications and composition:** Board members should be and remain qualified, individually and collectively, for their positions. They should understand their oversight and corporate governance role and be able to exercise sound, objective judgment about the affairs of the bank.

- **Principle 3: Board's own structure and practices:** The board should define appropriate governance structures and practices for its own work, and put in place the means for such practices to be followed and periodically reviewed for ongoing effectiveness.
- **Principle 4: Senior management:** Under the direction and oversight of the board, senior management should carry out and manage the bank's activities in a manner consistent with the business strategy, risk appetite, remuneration and other policies approved by the board.
- **Principle 5: Governance of group structures:** In a group structure, the board of the parent company has the overall responsibility for the group and for ensuring the establishment and operation of a clear governance framework. The board and senior management should know and understand the bank group's operational structure and the risks that it poses.
- **Principle 6: Risk management function:** Banks should have an effective independent risk management function, under the direction of a chief risk officer (CRO).
- **Principle 7: Risk identification, monitoring and controlling:** Risks should be identified, monitored and controlled on an ongoing bank-wide and individual entity basis.
- **Principle 8: Risk communication:** An effective risk governance framework requires robust communication within the bank about risk, both across the organisation and through reporting to the board and senior management.
- **Principle 9: Compliance:** The bank's board of directors is responsible for overseeing the management of the bank's compliance risk. The board should approve the bank's compliance approach and policies, including the establishment of a permanent compliance function.
- **Principle 10: Internal audit:** The internal audit function provides independent assurance to the board and supports board and senior management in promoting an effective governance process and the longterm soundness of the bank.
- **Principle 11: Compensation:** The bank's compensation structure should be effectively aligned with sound risk management and should promote long term health of the organisation and appropriate risktaking behavior.
- **Principle 12: Disclosure and transparency:** The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.
- **Principle 13: The role of supervisors:** Supervisors should provide guidance for and supervise corporate governance at banks, including through comprehensive evaluations and regular interaction with boards and senior management, should require improvement and remedial action as necessary, and should share information on corporate governance with other supervisors.

GUIDELINES ON CORPORATE GOVERNANCE FOR NBFCs

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

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

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| Constitution of Audit Committee : | <ul style="list-style-type: none"> ➤ An NBFC having assets of Rs. 50 crore and above as per its last audited balance sheet is already required to constitute an Audit Committee. ➤ Consisting of not less than three members of its Board of Directors, |
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| | <ul style="list-style-type: none"> ➤ NBFC-D with deposit size of Rs 20 crore may also consider constituting an Audit Committee on similar lines. |
| Constitution of Nomination Committee: | <ul style="list-style-type: none"> ➤ NBFCs with Asset size of Rs 100 crore and above AND ➤ Deposit size of Rs 20 crore and above. |
| Constitution of Risk Management Committee: | <ul style="list-style-type: none"> ➤ Public Deposit of Rs.20 crore and above or ➤ Having an asset size of Rs.100 crore or above as on the date of last audited balance sheet |
| Disclosure and transparency: | <ul style="list-style-type: none"> ➤ progress made in putting in place a progressive risk management system, and risk management policy and strategy followed; ➤ Conformity with corporate governance standards viz. in composition of various committees, their role and functions, periodicity of the meetings and compliance with coverage and review functions, etc. |
| Rotation of partners of the statutory auditors audit firm | <ul style="list-style-type: none"> ➤ NBFCs with public deposits / deposits of Rs 50 crore and above <p>Shall stipulate rotation of partners of audit firms appointed for auditing the company. The partner/s of the Chartered Accountant firm conducting the audit could be rotated every three years so that same partner does not conduct audit of the company continuously for more than a period of three years. However, the partner so rotated will be eligible for conducting the audit of the NBFC after an interval of three years, if the NBFC, so decides.</p> |

CORPORATE GOVERNANCE GUIDELINES FOR INSURANCE COMPANIES

The Insurance Regulatory and Development Authority of India (IRDAI) issued Guidelines on Corporate Governance for insurance companies vide circular dated 5th August, 2009. The Authority had also issued separate guidelines for **appointment/ reappointment and remuneration of MD/CEO/ WTD** as well as **other Key Management Persons (KMPs)** and also the **Appointment of statutory auditors of insurers** through various circulars. The IRDAI revised the existing Guidelines in the light of changes brought in by the Companies Act, 2013.

These guidelines are applicable to all insurers granted registration by the Authority **except:**

- **Reinsurance companies** may **not be required** to have the **Policyholders' Protection Committee**; and
- **Branches of foreign reinsurers in India** may not be required to **constitute the Board** and its **mandatory committees** as indicated herein.

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

1. Governance Structure

The insurance companies presently could have different structures with the Board of Directors headed by a Executive or Non-executive Chairman with distinct oversight responsibilities over the other Directors and Key Management Persons. It is expected that whatever form is taken, the broader elements of good Corporate Governance are present.

2. Board of Directors

a. Composition:

- The Insurance Act stipulates that the insurance companies in India would be public companies and hence, would **require a properly constituted Board**.
- 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**.
- Insurance companies should ensure that the Board comprises of competent and qualified Directors to drive the strategies in a manner that would sustain growth and protect the interests of the stakeholders.
- The Board of Directors is required to have a minimum of **three “Independent Directors”**. However, this requirement is relaxed to **‘two’ independent directors**, for the initial **five years** from grant of Certificate of Registration to insurers. An independent Director shall **fulfill all the conditions specified under Section 149 of the Companies Act, 2013**.
- In case the number of independent directors falls below the required minimum laid down, such vacancy shall be filled up:
 - **Before the immediately following Board meeting or**
 - **3 months from the date of such vacancy, whichever is later**
- **As required under Section 149 of the Companies Act, 2013, there shall be at least one Woman Director on the Board of every Insurance company.**

b. The Role and responsibility of the Board: The specific areas of responsibilities of the Board of insurers are provided as under-

- I. The Board should ensure that the Governance principles set for the insurer comply with **all relevant laws, regulations and other applicable codes of conduct**.
- II. The Board should set the following policies in consultation with the Management of the Company.
 - Define and periodically **review the business strategy**.
 - Define the **underwriting policy** of the insurer.
 - Define the insurer’s policy on appointments and qualification requirements for human resources and ensure that the incentive structure does not encourage imprudent behaviour.
- III. **The Board should define and set the following standards:-**
 - Define the standards of business conduct and ethical **behaviour for directors and senior management**.
 - Define the standards to be maintained in policyholder servicing and **in redressal of grievances of policyholders**.
- IV. The Board would be responsible to provide guidance for implementation of business strategy and review the same periodically.
- V. As an integral part of proper implementation of the business strategy, the Board should take action as under:-

- Ensure that **all directions of IRDAI** are submitted to the Board and the **recommendations are implemented as per the Board philosophy.**
- Ensure that the company has put in place a **robust compliance system** for all applicable laws and regulations.
- Prescribe requirements and frequency of reporting in respect of each of the above areas of responsibility as may be decided by the Board.

c. Eligibility Criteria:

The Directors of insurers have to meet **the “fit and proper” criteria.** Currently, the fit and proper requirements seek to ensure that the Director should not have been convicted or come under adverse notice of the laws and regulations involving moral turpitude or of any professional body.

d. Disclosures about Meetings of the Board and its Committees:

Insurers shall ensure **compliance with the provisions of the Companies Act, 2013** and the **Secretarial Standards issued by the ICSI** from time to time as regards conduct of the meetings of the Board of Directors and their committees. In addition to the above, all insurers shall disclose the following in the Director’s Report:

- **Number of meetings of the Board of Directors and Committees mandated** under these Guidelines, in the **financial year;**
- Details of the composition of the **Board of Directors and Committees mandated, setting out name, qualification, field of specialization, status of directorship held** etc.
- **Number of meetings attended** by the **Directors and members of the Committee;**
- **Details of the remuneration paid,** if any, to all directors (**including Independent Directors**).

e. Control Functions:

Given the risks that an insurer takes in carrying out its operations, and the potential impact it has on its business, it is important that the Board lays down the policy framework to put in place:

- **robust and efficient mechanisms for the identification, assessment, quantification, control, mitigation and monitoring of the risks;**
- **appropriate processes for ensuring compliance with the Board approved policy, and applicable laws and regulations;**
- **appropriate internal controls to ensure that the risk management and compliance policies are observed;**

3. MANDATORY COMMITTEES OF THE BOARD

A. Audit Committee (mandatory):

Every Insurer shall constitute an Audit **Committee as per Section 177 of the Companies Act, 2013 and will play role provided as provided under the Act.** As required under Section 177 of the Companies Act, 2013, the Audit Committee shall comprise of a **minimum of three directors, majority of whom shall be Independent Directors.**

B. Investment Committee (mandatory):

The Board of every Insurer shall **set up an Investment Committee comprising of at least two Non-Executive Directors, the Chief Executive Officer, Chief of Finance, Chief of Investment, Chief Risk Officer and, the Appointed Actuary.** The responsibilities of the Committee to recommend:

- Investment policy and lay down the operational framework for the investment operations of the insurer.

The policy should focus **on a prudential Asset Liability Management (ALM)** supported by **robust internal control systems.**

C. Risk Management Committee (mandatory):

It is now well recognized that the **sound management of insurance in pursuit of development of a strong risk management system and mitigation strategies**, insurers shall set up a separate Risk Management Committee to implement the company's Risk Management Strategy. The risk management function should be under the **overall guidance and supervision of the Chief Risk Officer (CRO) with a clearly defined role.**

D. Policyholder Protection Committee (mandatory):

The Authority is mandated by statute to **protect policyholders' interests** and therefore adoption of sound and healthy market practices in terms of **sales, marketing, advertisements, promotion, publicity, redressal of customer grievances, consumer awareness and education is essential.**

Such Committee shall be **headed by a Non-Executive Director** and shall include an expert/representative of customers as an invitee to enable insurers to formulate policies and assess compliance thereof.

E. Nomination and Remuneration Committee (mandatory):

The Nomination and Remuneration Committee shall be constituted in line with the provisions of Section 178 of the Companies Act, 2013. Indian Insurance Companies which have constituted two independent committees for Nomination and Remuneration separately may merge these **two Committees after seeking the Board approval, under intimation to the Authority, within a period of 180 days from the date of issue of these guidelines.**

F. Corporate Social Responsibility Committee ('CSR Committee') (mandatory):

Section 135 of the Companies Act, 2013 requires constitution of a CSR Committee if certain conditions as mentioned in the said Section are fulfilled. For Indian Insurance Companies, a CSR Committee is required to be set up if the insurance company earns a **Net Profit of Rs. 5 Crores or more during the preceding financial year.** In line with Section 135(5) of Companies Act, 2013, the Board of Directors of the Company shall ensure that the Company **spends not less than 2% of the three years' average Net Profits as defined above towards the CSR activities.**

PROFITS COMMITTEE:

The Authority has issued IRDA (Non-Linked Insurance Products) Regulations 2013, which lay down the framework about the With Profit Fund Management and Asset sharing, among other things. In terms of these Regulations, every Insurer transacting life insurance business shall constitute a With Profits Committee comprising of **an Independent Director, the CEO, The Appointed Actuary and an independent Actuary.** The Committee shall meet as often as is required to transact the business and carry out the functions of determining the following:

- **The share of assets attributable to the policyholders**
- **The investment income attributable to the participating fund of policyholders**
- **The expenses allocated to the policyholders**

The **report of the With Profits Committee** in respect of the above matters should be **attached to the Actuarial Report and Abstract furnished by the insurers to the Authority.**

4. Role of Appointed Actuaries

IRDAI has brought out detailed Regulations on Appointed Actuary vide IRDA (Appointed Actuary) Regulations, 2000, detailing the procedure for his appointment, qualifications, powers along with his duties and obligations. The Regulations also stipulate that prior approval of the Authority shall be taken for the appointment of the Appointed Actuary.

- **A procedure for appointment of Appointed Actuary should be put in place.**
- **The Appointed Actuary should qualify and satisfy the 'Fit & Proper' criteria and other eligibility conditions as mentioned in IRDA (Appointed Actuary) Regulations, 2000, as amended from time to time.**

- As soon as the Appointed Actuary realizes that the entity does not comply or is likely to fail in complying with the requirements of solvency and other parameters of sound operations, he/she shall inform the Board of the insurer. If no viable/acceptable action is taken by the Board, then he/she has to inform the same to IRDAI.
- **The Appointed Actuary shall provide professional advice or certification** to the board with regard to:-
 - **Financial condition testing**
 - **Solvency margin requirements**
 - **Appropriateness of premiums (and surrender value)**
 - **Allocation of bonuses to with-profit insurance contracts**
 - **Estimation of technical provisions in accordance with the valuation framework set up by the insurer.**

5. External Audit - Appointment of Statutory Auditors

The IRDAI (Preparation of Financial Statements and Auditors' Report of Insurance Companies) Regulations, 2002 empower the Authority to issue directions/guidelines on appointment, continuance or removal of auditors of an insurer. **These guidelines/directions may include prescriptions on qualifications and experience of auditors, their rotation, period of appointment,** etc. as may be deemed necessary by the Authority.

The Board should therefore ensure that the statutory auditors are compliant with the regulatory requirements and there are **no conflicts of interest in their appointment.**

The auditors should possess the **competence and integrity to alert** the appropriate authorities promptly of any event that could **seriously affect the insurance company's financial position.**

6. Disclosure Requirements

In the meantime, it may be ensured by the Board that the information on the following, including the basis, methods and assumptions on which the information is prepared and the impact of any changes therein are also disclosed in the annual accounts:-

- **Actual solvency margin details vis-à-vis the required margin.**
- **Description of the risk management architecture.**
- **Payments made to group entities from the Policyholders Funds.**
- **Elements of remuneration package(including incentives) of MD & CEO and all other directors and Key Management Persons.**
- **Details of number of claims intimated, disposed off and pending with details of duration.**
- **Any other matters, which have material impact on the insurer's financial position.**

Where finalization of annual accounts extends beyond 90 days from the end of the Financial Year, the status on disclosure in the financial statements required under this clause may be made within 15 days of adoption of annual accounts by the Board of Directors of the Insurers.

7. Interaction with the Regulator

Effective corporate governance practices in the office of the insurance company will enable IRDAI to have greater **confidence in the work and judgment of its board, Key Management Persons and control functions.** In assessing the governance practices in place, the IRDAI would:

- **Assess the fitness and propriety of board members;**
- **Monitor the performance of boards;**
- **Assess the quality of insurance company's internal reporting, risk management, audit and control functions;**

- **Evaluate the effects of the insurance company’s group structure on the governance strategies;**

Assess the adequacy of governance processes in the area of crisis management and business continuity. The IRDAI would bring to the attention of the Board and senior management, concerns which have been detected by it through supervisory activities.

8. Whistle Blower Policy

Insurers are well advised to put in place a **“whistle blower” policy, where-by mechanisms exist for employees to raise concerns internally about possible irregularities, governance weaknesses, financial reporting issues or other such matters.** These could include employee reporting in confidence directly to the Chairman of the Board or of a Committee of the Board or to the Statutory Auditor. The Policy illustratively covers the following aspects:

- **Awareness of the employees that such channels are available, how to use them and how their report will be handled.**
- **Handling of the reports received confidentially, for independent assessment, investigation and where necessary for taking appropriate follow-up actions.**
- **A robust anti-retaliation policy to protect employees who make reports in good faith.**
- **Briefing of the board of directors.**

The appointed actuary and the **statutory/internal auditors have the duty to ‘whistle blow’**, i.e., to **report in a timely manner to the IRDAI** if they are aware that the insurance company has failed to take appropriate steps to rectify a matter which has a material adverse effect on its financial condition. This would enable the IRDAI to **take prompt action before policyholders’ interests are undermined.**

Evaluation of Board of Directors including Independent Directors

As required under **Schedule IV of the Companies Act, 2013**, the independent directors shall meet **at least once in a year to evaluate the performance of other than independent Directors.** Similarly, there shall be an evaluation of the Independent Directors by the other members of the Board of Directors as required in the Schedule.

STEWARDSHIP CODE FOR INSURERS IN INDIA

Stewardship Principles

| S. No. | Principles | Guidance |
|---------------|--|--|
| 1. | Insurers should formulate a policy on the discharge of their stewardship responsibilities and publicly disclose it. | Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. |
| 2. | Insurers should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it. | Insurers should put in place, maintain and publicly disclose a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of their client or beneficiary first |
| 3. | Insurers should monitor their investee companies. | Insurers should have mechanisms for regular monitoring of their investee companies in respect of their performance, leadership effectiveness, succession planning, corporate governance, reporting and other parameters they consider important. |
| 4. | Insurers should have a clear policy on | Insurers should set out the circumstances in which they will actively intervene and regularly assess the |

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| | intervention in their investee companies. | outcomes of doing so. The meetings should be held in a confidential manner with the view to resolve the issue constructively. If dissatisfied with the response of the investee company, the insurer may decide to escalate the matter, in accordance with the pre-defined policy. |
| 5. | Insurers should have a clear policy for collaboration with other institutional investors, where required, to preserve the interests of the policyholders (ultimate investors), which should be disclosed. | For issues that require larger engagement with the investee company, insurers may choose to act collectively with other institutional investors in order to safeguard the interests of their investors. For such situations, the insurers should have a policy to guide their actions and extent of engagement. |
| 6. | Insurers should have a clear policy on voting and disclosure of voting activity | Insurers should not just blindly support the board of the investee company but, instead, take their own voting decisions to promote the overall growth of the investee companies and, in turn, enhance the value of their investors. Insurers should disclose their approach to stock lending and recalling lent stock. |
| 7. | Insurers should report periodically on their stewardship activities. | In addition to the regular fulfilment of their stewardship activities, institutional investors should also provide a periodic report to their ultimate beneficiaries (policyholders) of how they have discharged their responsibilities, in a format which is easy to understand. |

Disclosure and Reporting:

All insurers shall furnish a report on an annual basis to the IRDAI, on the status of compliance with the Stewardship Code. The **status report, approved by the Board** shall be endorsed by the **Compliance Officer and should be submitted on or before 30th June every year**. The reporting should be done under the **principle of “comply or explain”, the reasons for deviation or non-compliance** with the Stewardship Principles should be provided in the report.

CORPORATE GOVERNANCE IN PUBLIC SECTOR ENTERPRISES

Department of Public Enterprises (DPE) is the nodal department for issuing the corporate governance guidelines for the Public Sector Enterprises for both at center and state level. Since **Government is the major shareholder in Public Sector Undertakings (PSUs)/Central Public Sector Enterprises (CPSEs)**, it is responsible to **set the high standard of governance** to be followed by these public sector enterprises. As the government’s disinvestment strategy gathers momentum, there is a genuine need to improve the levels of transparency, and accountability within PSUs.

For the purpose of DPE Guidelines on Corporate Governance, CPSEs have been categorised into two groups, namely,

- **Those listed on the Stock Exchanges;**
- **Those not listed on the Stock Exchanges.**

CPSEs listed on Stock Exchanges: In so far as listed CPSEs are concerned, **they have to follow the SEBI (LODR) Regulations, 2015**. In addition, they shall follow those provisions in these Guidelines which

do not exist in the SEBI Guidelines and also do not contradict any of the provisions of the SEBI Guidelines.

Unlisted CPSEs: Each CPSE should strive to institutionalize good Corporate Governance practices broadly in conformity with the SEBI Guidelines. The listing of the non-listed CPSEs on the stock exchanges may also be considered within a reasonable time frame to be set by the Administrative Ministry concerned in consultation with the CPSEs concerned. **The non-listed CPSEs shall follow the Guidelines on Corporate Governance on a mandatory basis.**

DPE guidelines on Corporate Governance provide following governance **parameters:**

- **Board of Directors**
- **Audit Committee**
- **Remuneration Committee**
- **Subsidiary Companies**
- **Disclosures**
- **Report, Compliance and Schedule of Implementation.**

Salient features of Guidelines on Corporate Governance for Central Public Sector Enterprises 2010:

a. Board of Directors:

Composition of Board of Directors: The Board of Directors of the company shall have an optimum combination of Functional, Nominee and Independent Directors.

- **Functional Directors (including CMD/MD):** should **not exceed 50% of the actual strength of the Board.**
- **Nominee Directors:** Appointed by Government/other CPSEs shall be restricted to a **maximum of two.**
- **Independent Directors:** In case of a **CPSE listed on the Stock Exchanges** and whose Board of Directors is **headed by an Executive Chairman**, the **number of Independent Directors shall be at least 50% of Board Members;** and
in case of **all other CPSEs (i.e. listed on Stock Exchange but without an Executive Chairman, or not listed CPSEs)**, **at least one-third of the Board Members should be Independent Directors.**

Part-time Directors' compensation and disclosures: **All fees/compensation**, if any, paid to part-time Directors, including Independent Directors, shall be **fixed by the Board of Directors** subject to the provisions in the DPE guidelines and the Companies Act, 2013.

Number of Board meetings:-

- The Board shall meet **at least once in every three months** and
- At least **four such meetings** shall be held every year.
- Further the **time gap between any two meetings** should **not be more than three months.**

Number of Directorship:

- **A Director shall not be a member in more than 10 committees** or
- **Act as Chairman of more than five committees across all companies in which he is a Director.**

Compliance of Laws to be reviewed:- The **Board shall periodically review compliance reports** of all laws applicable to the company, prepared by the company as well as steps taken by the company to **rectify instances of non-compliances.**

Code of Conduct: The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be circulated and also posted on the website of the company.

Risk Management: Enterprise risk management helps management in achieving CPSE’s performance and profitability targets. It helps to ensure effective reporting and compliance with laws and regulations, and helps avoid damage to the entity’s reputation and associated consequences. The Board should **ensure the integration and alignment of the risk management system with the corporate and operational objectives and also that risk management is undertaken as a part of normal business practice and not as a separate task at set times.**

Training of Directors: The company concerned shall undertake **training programme for its new Board members (Functional, Government, Nominee and Independent)** in the business model of the company including **risk profile of the business of company.**

They shall also be imparted training on **Corporate Governance, model code of business ethics and conduct applicable for the respective Directors.**

b. Audit Committee:

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| <p>Qualified and Independent Audit Committee:</p> | <ul style="list-style-type: none"> ➤ The Audit Committee shall have minimum three Directors as members. ➤ Two-thirds of the members of audit committee shall be Independent Directors. ➤ The Chairman of the Audit Committee shall be an Independent Director. ➤ All members of Audit Committee shall have knowledge of financial matters of Company, and at least one member shall have good knowledge of accounting and related financial management expertise. ➤ The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries. ➤ The Company Secretary shall act as the Secretary to the Audit Committee. |
| <p>Role of Audit Committee:</p> | <ul style="list-style-type: none"> ➤ Oversight of the company’s financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible. ➤ Recommending to the Board the fixation of audit fees. ➤ Approval of payment to statutory auditors for any other services rendered by the statutory auditors. ➤ Reviewing, with the management, the quarterly financial statements before submission to the Board for approval. ➤ Reviewing, with the management, performance of internal auditors and adequacy of the internal control systems. ➤ Discussion with internal auditors and/or auditors any significant findings and follow up there on. ➤ Review all related party transactions in the company. For this purpose, the Audit Committee may designate a member who shall be responsible for reviewing related party transactions. ➤ Review with the independent auditor the co- |

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| | <p>ordination of audit efforts to assure completeness of coverage, reduction of redundant efforts, and the effective use of all audit resources.</p> <ul style="list-style-type: none"> ➤ Consider and review the following with the management, internal auditor and the independent auditor: <ul style="list-style-type: none"> • Significant findings during the year, including the status of previous audit recommendations. • Any difficulties encountered during audit work including any restrictions on the scope of activities or access to required information. |
| Powers of Audit Committee: | <ul style="list-style-type: none"> ➤ To investigate any activity within its terms of reference. ➤ To seek information on and from any employee. ➤ To obtain outside legal or other professional advice, subject to the approval of the Board of Directors. ➤ To secure attendance of outsiders with relevant expertise, if it considers necessary. ➤ To protect whistle blowers. |
| Meeting of Audit Committee | <ul style="list-style-type: none"> ➤ At least four times in a year and not more than four months shall elapse between two meetings. ➤ The quorum shall be either two members or one third of the members of the Audit Committee whichever is greater, but a minimum of two independent members must be present. |
| Review of information by Audit Committee. | <ul style="list-style-type: none"> ➤ Management discussion and analysis of financial condition and results of operations; ➤ Statement of related party transactions submitted by management; ➤ Management letters/letters of internal control weaknesses issued by the statutory auditors; ➤ Internal audit reports relating to internal control weaknesses; ➤ The appointment and removal of the Chief Internal Auditor shall be placed before the Audit Committee; |

c. Remuneration Committee:

Each CPSE shall constitute a Remuneration Committee comprising of at least three Directors, all of whom should be part-time Directors (i.e. Nominee Directors or Independent Directors). The Committee should be headed by an Independent Director.

d. Subsidiary Companies:

- **At least one Independent Director on the Board of Directors of the holding company shall be a Director on the Board of Directors of its subsidiary company.**
- **The Audit Committee of the holding company shall also review the financial statements of its subsidiary company.**
- **The minutes of the Board meetings of the subsidiary company shall be placed at the Board meeting of the holding company.**

e. Disclosures:

Transactions: A statement in summary form of transactions with related parties in the normal and ordinary course of business shall be placed periodically before the Audit Committee.

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

Board Disclosures – Risk management:

- The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. Procedure will be laid down for internal risk management also.
- The Board should implement policies and procedures which should include:
 - **staff responsibilities in relation to fraud prevention and identification**
 - **Responsibility of fraud investigation once a fraud has been identified;**
 - **Process of reporting on fraud related matters to management;**
 - **Reporting and recording processes to be followed to record allegations of fraud**
 - **Requirements of training to be conducted on fraud prevention and identification.**

Remuneration of Directors:

- All pecuniary relationship or transactions of the part-time Directors vis-à-vis the company shall be disclosed in the Annual Report.
- Further the following disclosures on the remuneration of Directors shall be made in the section on the Corporate Governance of the Annual Report:
 - **All elements of remuneration package of all the directors i.e. salary, benefits, bonuses, stock options, pension, etc.**
 - **Details of fixed component and performance linked incentives, along with the performance criteria.**

Management:

As part of the Directors Report or as an addition thereto, a Management Discussion and Analysis Report should form part of the Annual Report. This Management Discussion and Analysis should include discussion on the following matters within the limits set by the company's competitive position:

- **Industry structure and developments,**
- **Strength and weakness**
- **Opportunities and Threats**
- **Segment-wise or product-wise performance**
- **Outlook**
- **Risks and concerns**
- **Internal control systems and their adequacy**
- **Discussion on financial performance with respect to operational performance**
- **Material developments in Human Resources, Industrial Relations front, including number of people employed.**
- **Environmental Protection and Conservation, Technological conservation, Renewable energy developments, Foreign Exchange conservation**
- **Corporate social responsibility.**

Report on Corporate Governance:

There shall be a separate section on Corporate Governance in each Annual Report of company, with details of compliance on Corporate Governance.

Compliance:

The company shall obtain a certificate from either the auditors or practicing Company Secretary regarding compliance of conditions of Corporate Governance as stipulated in these Guidelines.

Schedule of implementation:

The CPSEs shall submit **quarterly progress reports, within 15 days from the close of each quarter**, in the prescribed format to respective Administrative Ministries/ Departments.

**GUIDELINES ON CORPORATE SOCIAL RESPONSIBILITY AND SUSTAINABILITY FOR
CENTRAL PUBLIC SECTOR ENTERPRISES (WITH EFFECT FROM 1ST APRIL, 2013)**

After the enactment of the Companies Act 2013, all CPSEs shall have to comply with the provisions of the Act and the CSR Rules.

The guidelines contain certain additional requirements as mentioned below:

- 1. It is mandatory for all profit making CPSEs to undertake CSR activities as per the provisions of the Act and the CSR Rules. Even the CPSEs which are not covered under the eligibility criteria based on threshold limits of net-worth, turnover, or net profit as specified by Section 135 (1) of the Act, but which made profit in the preceding year, would also be required to take up CSR activities as specified in the Act and the CSR Rules.**
- 2. All CPSEs must adopt a CSR and Sustainability Policy specific to their company with the approval of the Board of Directors.**
- 3. It would be mandatory for all CPSEs which meet the criteria as laid down in Section 135(1) of the Act, to spend at least 2% of the average net profits of the three immediately preceding financial years in pursuance of their CSR activities as stipulated in the Act and the CSR Rules.**
- 4. While selecting CSR activities / projects from the activities listed in Schedule VII of the Act, CPSEs should give priority to the issues which are of foremost concern in the national development agenda, like safe drinking water for all, provision of toilets especially for girls, health and sanitation, education, etc.**
- 5. As mentioned in the Act, CPSEs should give preference to the 'local area' in selecting the location of their CSR activities.**
- 6. After giving due preference to the local area, CPSEs may also undertake CSR activities anywhere in the country.**
- 7. Within the provisions of the Act, Schedule VII of the Act, and the CSR Rules, CPSEs are encouraged to take up CSR activities / projects in collaboration with other CPSEs for greater social, economic and environmental impact of their CSR activities/projects.**

SOME EXAMINATION QUESTIONS

- 1.** What do you mean by the Corporate Governance? How the governance norms are applicable in the banks.
- 2.** Discuss the salient features of the Ganguly Committee Report applicable to Private Sector Banks.
- 3.** IRDA has issued the guidelines on Corporate Governance Norms for the Insurance Companies. Please mention the salient features of it.
- 4.** Public Sector Undertakings also have to adhere to the norms of the Corporate Governance. What guidelines have been issued by the Ministry in this regard?
- 5.** Comments on the Corporate Social Responsibility.
- 6.** DPE has issued the guidelines on Corporate Governance for the CPSEs. Discuss in brief.

CHAPTER 3

Board Effectiveness

ROLE OF THE BOARD OF DIRECTORS

The role of Board in particular includes:

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

TYPES OF DIRECTORS UNDER COMPANIES ACT 2013



1. Executive Director :

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

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

Executive directors are **employed by the company and paid a salary**, so are protected by employment law. Examples of executive directors are **production director, finance director or managing director or whole time director**.

2. Non Executive Director:

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

Therefore, one can opine that all the Directors except 'Whole Time Director' and "Managing Director" shall be considered as Non- Executive Director.

3. Shadow Director:

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

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

Section 2(60)(v) wherein, the meaning of “officer who is in default” includes within itself any person in accordance with whose directions or instructions the Board of directors of the company usually acts.

4. 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:**

- **every listed company;**
- **every other public company having:**
 - **Paid-up share capital of one hundred crore rupees or more; or (100 cr. or more)**
 - **Turnover of three hundred crore rupees or more. (300 cr. Or more)**

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

SEBI (LODR) (Amendment) Regulations, 2018 provides that the **top listed 500 companies** shall have **at least one independent woman director** by 1 April 2019 and for the **top listed 1000 entities** by 1 April 2020.

5. Resident Director:

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

6. Independent Director:

Independent Directors play a pivotal role in maintaining a transparent working environment in the corporate regime. Independent Directors constitute such category of Directors who are expected to have impartial and objective judgment for the proper functioning of the company. **Section 2(47) of the Companies Act 2013 provides that “independent director” means an independent director referred to in sub-section (6) of section 149.**

7. Nominee Director:

A nominee director belongs to the category of **non-executive director and is appointed on behalf of an interested party.** It is pertinent to mention here that there is a divergent view as to whether a nominee director can be considered independent or not. **Naresh Chandra Committee** in its report stated that ‘nominee director’ will be excluded from the pool of directors in the determination of the number of independent directors.

In other words, such a director will not feature either in the numerator or the denominator. Both SEBI (LODR) Regulations, 2015 and section 149(6) of the Companies Act, 2013 specifically **exclude nominee director** from being considered as Independent.

8. Small Shareholders Director:

According to Section 151 of the Companies Act, 2013 every listed company may have one director elected by “small shareholders”.

For the purpose of this section, “small shareholder” means a shareholder holding shares of **nominal value of not more than twenty thousand rupees** or such other sum as may be prescribed.

Rule 7 of companies act 2013 laid down the terms and conditions for appointment of Small Shareholder’s Director. **A listed company, may upon notice of not less than 1000 or one-tenth of the**

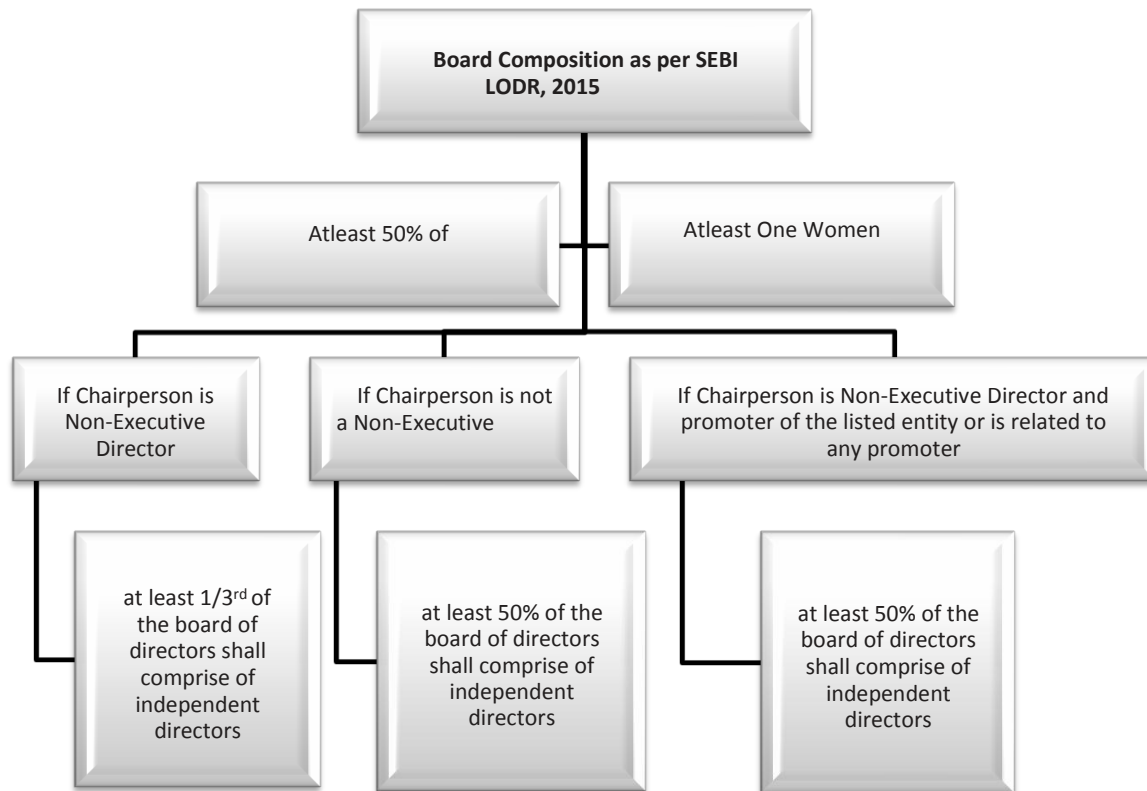
total number of small shareholders, whichever is lower, have a Small Shareholders' Director elected by the small shareholders. A listed company may suo moto (on its own accord) opt to have a director representing small shareholders.

COMPOSITION AND STRUCTURE OF BOARD

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

| Particulars | Companies Act, 2013 | SEBI (LODR) Regulations, 2015 |
|-------------------|---|--|
| Size of the Board | <p>Section 149(1) provides every company shall have a Board of Directors consisting of individuals as directors and shall have –</p> <ul style="list-style-type: none"> ➤ A minimum number of three directors in the case of a public company, ➤ Atleast two directors in the case of a private company, and ➤ Atleast one director in the case of a One Person Company; and ➤ A maximum of fifteen directors provided that a company may appoint more than fifteen directors after passing a special resolution. <p>Note: Maximum directors' clause not applicable to Government Company and Section 8 Company.</p> | <ul style="list-style-type: none"> ➤ Regulation 17(1)(a) provides that Board of directors shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty per cent. of the board of directors shall comprise of non-executive directors; ➤ The top listed 500 companies shall have atleast one independent woman director by 1 April 2019 and for the top listed 1000 entities by 1 April 2020. ➤ Regulation 17(1)(c) provides the board of directors of the top 1000 listed entities (with effect from April 1, 2019) and the top 2000 listed entities (with effect from April 1, 2020) shall comprise of not less than six directors. |

| | | |
|---------------------------------|---|---|
| <p>Board Composition</p> | <p>Section 149(4) provides that every public listed company shall have at least one third of total number of directors as independent directors and Central Government may prescribe the minimum number of independent directors in any class or classes of companies.</p> <p>Note: Not applicable to Government Company and IFSC Public Company</p> <p>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:</p> <ul style="list-style-type: none"> ➤ 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. <p>The following classes of unlisted public company shall not be covered under sub-rule (1), namely:-</p> <ul style="list-style-type: none"> • a joint venture; • a wholly owned subsidiary; • dormant company as defined under section 455 of the Act.”] | <p>Regulation 17 (1) (b) provides that the composition of board of directors of the listed entity shall be as follows:</p> <ul style="list-style-type: none"> ➤ where the chairperson of the board of directors is a non-executive director, at least one-third of the board of directors shall comprise of independent directors and ➤ where the listed entity does not have a regular non-executive chairperson, at least half of the board of directors shall comprise of independent directors: <p>Provided that where the regular non-executive chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of board of director or at one level below the board of directors, at least half of the board of directors of the listed entity shall consist of independent directors.</p> |
|---------------------------------|---|---|



| | |
|--------------------|--------------------------------|
| SECTION 166 | DUTIES OF THE DIRECTORS |
|--------------------|--------------------------------|

1. **Subject to the provisions of this Act, a director of a company shall act in accordance with the articles of the company.**
2. A director of a company **shall act in good faith in order to promote the objects of the company** for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.
3. A director of a **company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.**
4. A director of a company **shall not involve in a situation** in which he **may have a direct or indirect interest that conflicts,** or possibly may conflict, with the interest of the company.
5. A director of a company **shall not achieve or attempt to achieve any undue gain or advantage** either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.
6. A director of a company **shall not assign his office and any assignment** so made shall be void.
7. If a director of the company **contravenes** the provisions of this section such director shall be **punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.**

POWERS OF THE BOARD

a As per **Section 179(3) read with Rule 8 of Companies (Meetings of Board and its Powers) Rules, 2014**, the Board of Directors of a company shall exercise the following powers on behalf of the company by means of resolutions passed at meetings of the Board, namely:

- to make calls on shareholders in respect of money unpaid on their shares;
- to **authorise buy-back** of securities under section 68;
- to issue securities, including debentures, **whether in or outside India**;
- to borrow monies; (5) to **invest the funds of the company**;
- to grant loans or give guarantee or provide security in respect of loans;
- to **approve financial statement and the Board's report**;
- to diversify the business of the company;
- to approve **amalgamation, merger or reconstruction**;
- to take over a company or acquire a controlling or substantial stake in another company;
- **to make political contributions**;
- **to appoint or remove key managerial personnel (KMP)**;
- **to appoint internal auditors and secretarial auditor**.

Section 180 of the Act imposes restrictions on the powers of the Board. It provides that the board can exercise the following powers only with the consent of the company by **special resolution**:-

- 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;
- to invest otherwise in trust securities the amount of compensation received by it as a result of **any merger or amalgamation**;
- **to borrow money, where the money to be borrowed**, together with the money already borrowed by the company will **exceed aggregate of its paid-up share capital and free reserves and securities premium**, apart from temporary loans obtained from the company's bankers in the ordinary course of business;
- 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**.

INDEPENDENT DIRECTORS FOR BETTER BOARD EFFECTIVENESS

Independent directors are required because they perform the following important role:

- Balance the often conflicting interests of the stakeholders.
- Facilitate withstanding and countering pressures from owners.
- Fulfill a useful role in succession planning.
- Act as a coach, mentor and sounding Board for their full time colleagues.
- Provide independent judgment and wider perspectives.

Section 149(6) of Companies Act, 2013 defines independent director as below:

- (1) Every listed public company shall have at least one-third of the total number of directors as independent directors

Also refer SEBI LODR

AND

- (a) the Public Companies having paid up share capital of ten crore rupees or more; or
- (b) the Public Companies having turnover of one hundred crore rupees or more; or
- (c) the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees: shall have atleast TWO INDEPENDENT DIRECTORS.

Explanation.--For the purposes of this sub-section, any fraction contained in such one-third number shall be rounded off as one.

The following classes of unlisted public company shall not be required to appoint independent director:-

- a) A joint venture;
- b) A wholly owned subsidiary; and
- c) A dormant company as defined under section 455 of the ACT.

CRITERIA OF INDEPENDENT DIRECTOR

- (2) 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;

In case of Government Companies The opinion of Ministry or Department of the Central Government which is administratively in charge of the Company, or, as the case may be, the State Government shall be considered to determine integrity and relevant expertise and experience for appointing Independent Director and not of the Board of the Company.

- (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 **apart from receiving any remuneration, has or had no pecuniary relationship** other than **Remuneration as such Director or having transaction not exceeding ten %** of his total income or such amount as may be prescribed with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year; **(Not applicable to Government Companies)**
- (d) **none of whose relatives —**
 - (i) *is holding any security of or interest in the company, its holding, subsidiary or associate company during the two immediately preceding financial years or during the current financial year:*
Provided that the relative may hold security or interest in the company of face value not exceeding fifty lakh rupees or two percent, of the paid-up capital of the company, its holding, subsidiary or associate company or such higher sum as may be prescribed;

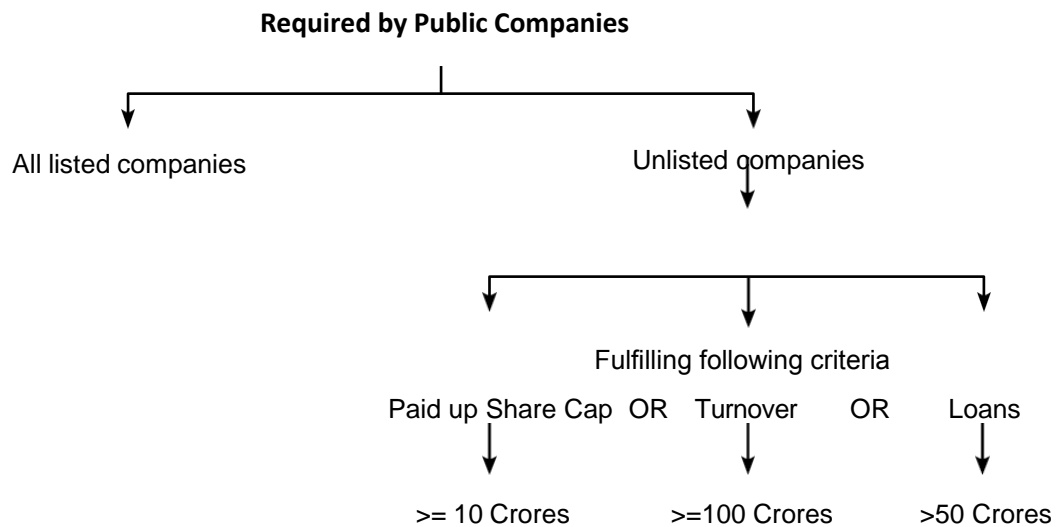
- (ii) is indebted to the company, its holding, subsidiary or associate company or their promoters, or directors, in excess of Rs. 50 lakhs **at any time during** the two immediately preceding financial years or during the current financial year;
- (iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company, for Rs. 50 lakhs **at any time during** the two immediately preceding financial years or during the current financial year; or
- (iv) has any other pecuniary transaction or relationship with the company, or its subsidiary, or its holding or associate company amounting to two percent or more of its gross turnover or total income singly or in combination with the transactions referred to in sub-clause (i), (ii) or (iii).

(e) who, neither himself nor any of his relatives--

- (i) **holds or has held the position of a key managerial personnel** or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

Provided that in case of a relative who is an employee, the restriction under this clause shall not apply for his employment during preceding three financial years.

- (ii) **is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of--**



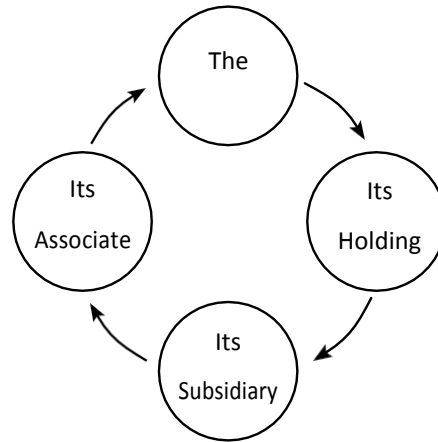
*LOGIC : (Chota Company for better governance)
(Loro ka paisa uthaya hai)*

Criteria for becoming an
Independent Director

- **A Director**
- ~~Managing Director~~
- ~~Whole Time Director~~
- ~~Nominee Director~~
- WHO IN THE OPINION OF BOARD IS A PERSON OF INTEGRITY AND POSSESS RELEVANT EXPERTISE

- Is or was not a promoter
- Is not related to promoters or directors

***6 KA CHAKRAVYUH**



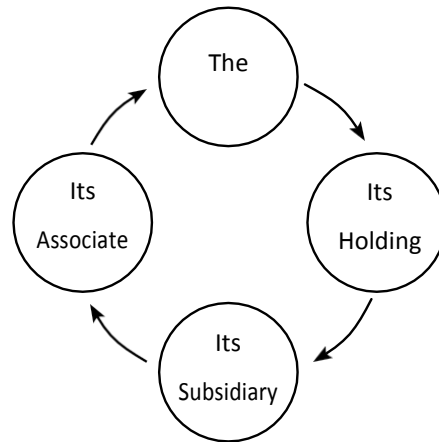
Their Promoters and Directors as well

HIS HIMSELF HAS OR HAD

- Only receives remuneration
- In no pecuniary relationship with
- Exceeding 10% of Director's Total Income

***6 KA CHAKRAVYUH**

**Last two immediately preceding
Financial Year or Current Year**



Their Promoters and Directors as well

Neither Himself nor his Relative

1) HOLDS OR HAS HELD

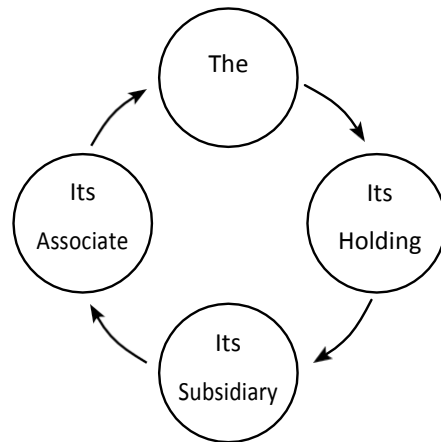
|

Position of KMP or Employee
(MD, WD, CS, CEO CFO etc.)

|

4 KA CHAKRAVYUH

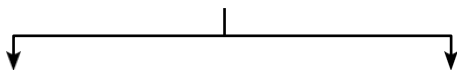
**In any Three Financial Year
immediately preceding the Current
Financial Year**



Neither Himself nor his Relative

2) IS OR BEEN

Employee, Proprietor or a Partner



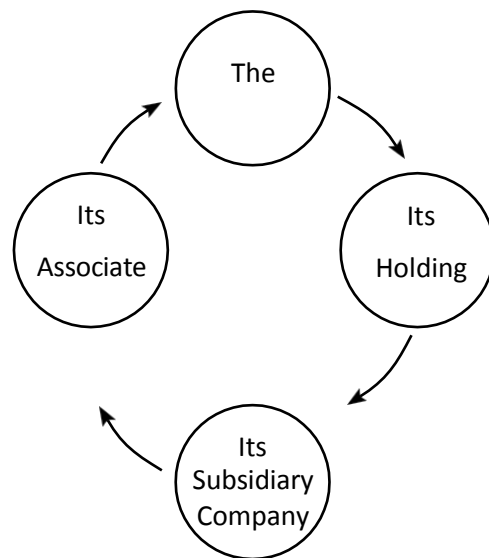
Audit Firm, Practicing
CS, Cost Auditors of

Legal/Consulting Firm that
has transaction amounting
to 10% of GT with



4 KA CHAKRAVYUH

**In any Three Financial Year immediately
preceding the Current Financial Year**



Neither Himself nor his Relative

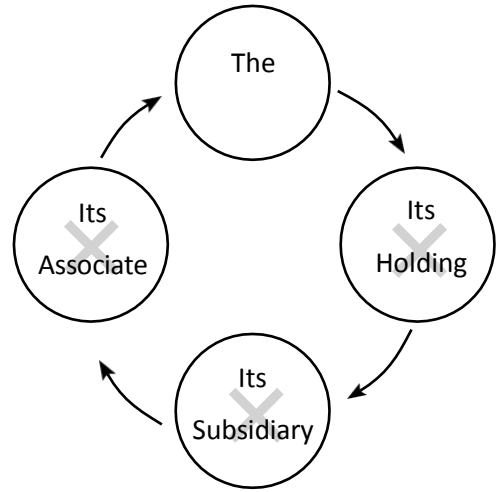
2) HOLDS

2% or more of voting power of THE COMPANY



1 KA CHARAVYUH

IN THE CURRENT FINANCIAL YEAR ONLY



Neither Himself nor his Relative

2) IS CEO or Director of



NGO



Receives 25% or more of its receipts from OR

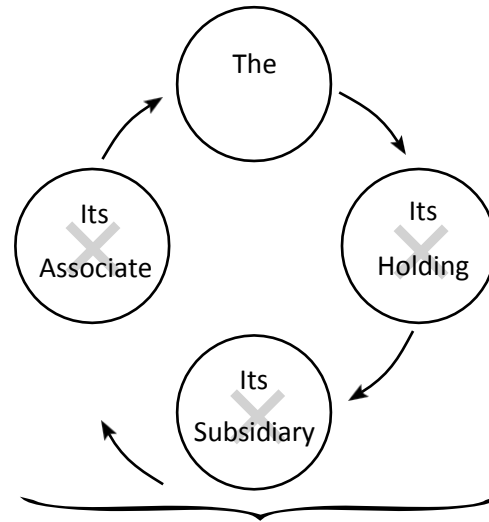
Holds 2% or more voting power of the COMPANY



6 KA CHARAVYUH

1 KA CHAKRAVYUH

IN THE CURRENT FINANCIAL YEAR



SPECIAL CASE : PROMOTERS & DIRECTORS OF THE CO.



1 KA CHAKRAVYUH

For holding voting power in the company

4 KA CHAKRAVYUH

For holding any position in the company

CHAKRAVYUH LOGIC

- (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;
Provided that in case of a Relative who is an employee, the Restriction under this clause shall not apply for his employment during Preceding three financial years.
 - (iii) holds together with his relatives two per cent. or more of the total voting power of the company; or
 - (iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or
- (g) who possesses such other qualifications as may be prescribed.

- (7) 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 as provided in sub-section (6).

This subsection shall not apply to a Section 8 company.

Explanation.--For the purposes of this section, "nominee director" means a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests.

- (8) The company and independent directors shall abide by the provisions specified in Schedule IV.
- (9) 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.

TENURE OF INDEPENDENT DIRECTOR:

- (10) Subject to the provisions of section 152, an independent director shall hold office for a term up to 5 consecutive years on the Board of a company, but shall be eligible for re-appointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.

COOLING OFF PERIOD (3 YEARS)

- (11) Notwithstanding anything contained in sub-section (10), no independent director shall hold office for more THAN 2 CONSECUTIVE TERMS, but such independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director:

Provided that an independent director shall not, during the said period of three years, be appointed in or be associated with the company in any other capacity, either directly or indirectly.

Explanation.--For the purposes of sub-sections (10) and (11), any tenure of an independent director on the date of commencement of this Act shall not be counted as a term under those sub-sections.

Liability of Independent Director

- (12) **Notwithstanding anything** contained in this Act,--
- (a) **an independent director;**
 - (b) **a non-executive director not being promoter or key managerial personnel, shall be held liable, ONLY in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.**
- (13) The provisions of sub-sections (6) and (7) of section 152 in respect of retirement of directors by rotation shall not be applicable to appointment of independent directors.

SCHEDULE IV

CODE FOR INDEPENDENT DIRECTORS

The Code is a guide to professional conduct for independent directors. **Adherence to these standards by independent directors and fulfilment 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.

I. GUIDELINES OF PROFESSIONAL CONDUCT:

An independent director shall:

- (1) **uphold ethical standards of integrity and probity;**
- (2) **act objectively and constructively while exercising his duties;**
- (3) **exercise his responsibilities in a bona fide manner in the interest of the company;**
- (4) **devote sufficient time and attention to his professional obligations for informed and balanced decision making;**
- (5) **not allow any extraneous considerations** that will vitiate his exercise of objective independent judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgment of the Board in its decisionmaking;
- (6) **not abuse his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person;**
- (7) **refrain from any action that would lead to loss of his independence;**
- (8) where circumstances arise which make an independent director lose his independence, the independent director must immediately inform the Board accordingly;
- (9) **assist the company in implementing the best corporate governance practices.**

II. ROLE AND FUNCTIONS:

The independent directors shall:

- (1) **help in bringing an independent judgment to bear on the Board's deliberations** especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct;
- (2) **bring an objective view in the evaluation** of the performance of board and management;
- (3) **scrutinise the performance of management** in meeting agreed goals and objectives and monitor the

reporting of performance;

- (4) **satisfy themselves on the integrity of financial information** and that financial controls and the systems of risk management are robust and defensible;
- (5) **safeguard the interests of all stakeholders**, particularly the minority shareholders;
- (6) **balance the conflicting interest of the stakeholders**;
- (7) determine appropriate levels of remuneration of executive directors, key managerial personnel and senior management and have a prime role in appointing and where necessary recommend removal of executive directors, key managerial personnel and senior management;
- (8) **moderate and arbitrate in the interest of the company** as a whole, in situations of conflict between management and shareholder's interest.

III. DUTIES:

The independent directors shall--

- (1) **undertake appropriate induction and regularly update** and refresh their skills, knowledge and familiarity with the company;
- (2) **seek appropriate clarification or amplification** of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;
- (3) **strive to attend all meetings of the Board of Directors** and of the Board committees of which he is a member;
- (4) **participate constructively and actively in the committees** of the Board in which they are chairpersons or members;
- (5) **strive to attend the general meetings of the company**;
- (6) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, **insist that their concerns are recorded in the minutes** of the Board meeting;
- (7) keep **themselves well informed about the company** and the external environment in which it operates;
- (8) **not to unfairly obstruct the functioning** of an otherwise proper Board or committee of the Board;
- (9) **pay sufficient attention and ensure that adequate deliberations** are held before approving related party transactions and assure themselves that the same are in the interest of the company;
- (10) **ascertain and ensure that the company has an adequate and functional** vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;
- (11) **report concerns about unethical behaviour**, actual or suspected fraud or violation of the company's code of conduct or ethics policy;
- (12) **acting within his authority, assist in protecting the legitimate interests of the company, shareholders and its employees**;
- (13) **not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans**, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.

IV. MANNER OF APPOINTMENT:

- (1) Appointment process of independent directors shall be independent of the company management; while selecting independent directors the Board shall ensure that there is appropriate balance of

skills, experience and knowledge in the Board so as to enable the Board to discharge its functions and duties effectively.

- (2) The appointment of independent director(s) of the company **shall be approved at the meeting of the shareholders.**
- (3) **The explanatory statement attached to the notice of the meeting for approving the appointment of independent director shall include a statement that in the opinion of the Board, the independent director proposed to be appointed fulfils the conditions specified in the Act and the rules made thereunder** and that the proposed director is independent of the management.
- (4) The appointment of independent directors **shall be formalised through a letter of appointment,** which shall set out:
 - (a) **the term of appointment;**
 - (b) **the expectation of the Board from the appointed director;** the Board-level committee(s) in which the director is expected to serve and its tasks;
 - (c) **the fiduciary duties that come with such an appointment along with accompanying liabilities;**
 - (d) **provision for Directors and Officers (D and O) insurance, if any;**
 - (e) **the Code of Business Ethics that the company expects its directors and employees to follow;**
 - (f) **the list of actions that a director should not do while functioning as such in the company; and**
 - (g) **the remuneration, mentioning periodic fees, reimbursement of expenses for participation in the Boards and other meetings and profit related commission, if any.**
- (5) **The terms and conditions of appointment of independent directors shall be open for inspection at the registered office of the company by any member during normal business hours.**
- (6) **The terms and conditions of appointment of independent directors shall also be posted on the company's website.**

V. RE-APPOINTMENT:

The re-appointment of independent director shall be on the basis of report of performance evaluation.

VI. RESIGNATION OR REMOVAL:

- (1) **The resignation or removal of an independent director shall be in the same manner as is provided in sections 168 and 169 of the Act.**
- (2) **An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director** within 3 (three) months from the date of such resignation or removal, as the case may be.
- (3) **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.**

VII. SEPARATE MEETINGS:

- (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.**

VIII. EVALUATION MECHANISM

- (4) The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.**
- (5) 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.**

For listed companies -Refer class dictation as per clause Sebi LOD

| | |
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| <p>Role of the lead independent director</p> | <ul style="list-style-type: none"> ➤ 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; ➤ 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. |
| <p>SEPARATION OF ROLE OF CHAIRMAN AND CHIEF EXECUTIVE OFFICER</p> | <p>The benefits of separation of roles of Chairman and CEO can be:</p> <ul style="list-style-type: none"> ➤ Director Communication: A separate chairman provides a more effective channel for the board to express its views on management ➤ Guidance: A separate chairman can provide the CEO with guidance and feedback on his/her performance ➤ Shareholders’ interest: The chairman can focus on shareholder interests, while the CEO manages the company ➤ Governance: A separate chairman allows the board to more effectively fulfill its regulatory requirements ➤ Long-Term Outlook: Separating the position allows the chairman to focus on the long-term strategy while the CEO focuses on short-term profitability ➤ Succession Planning: A separate chairman can more effectively concentrate on corporate succession plans. |
| <p>SUCCESSION</p> | <p>Some leading practices for board succession planning are:</p> |

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| <p>PLANNING</p> | <ul style="list-style-type: none"> ➤ Using a skills matrix to proactively shape board composition that incorporates strategic direction and opportunities, regulatory and industry developments, challenges, and transformation ➤ Conducting robust annual performance evaluations, including facilitation by an independent third party ➤ Establishing and enhancing written director qualification standards that align with the company’s business and corporate strategy, and including these standards in corporate governance policies and bylaws as appropriate ➤ Reviewing evolving committee and board leadership needs, including the time commitments required Considering director election results and engagement by investors regarding board composition, independence, leadership and diversity ➤ Prioritizing an independent mindset on boards, including through board diversity, to foster debate, challenge norms and invigorate board oversight processes and strategy development ➤ Making sure mentoring and development opportunities are available for incoming directors. |
| <p>DIRECTORS TRAINING, DEVELOPMENT AND FAMILIARISATION</p> | <p>Director Induction:</p> <ul style="list-style-type: none"> ➤ Briefing papers ➤ Internal visits ➤ Introductions <p>An induction programme should be available to enable new directors to gain an understanding of:</p> <ul style="list-style-type: none"> ➤ 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. <p>An induction kit should be given to new directors which should contain the following:</p> <ul style="list-style-type: none"> ➤ Memorandum and Articles of Association with a summary of most important provisions ➤ Brief history of the company ➤ Current business plan, market analysis and budgets ➤ Protocol, procedures and dress code for Board meetings, general meetings, , staff social events, site visits etc including the |

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| | <p>involvement of partners; Press releases in the last one year</p> <ul style="list-style-type: none"> ➤ copies of recent press cuttings and articles concerning the company ➤ Annual report for last three years ➤ Notes on agenda and Minutes of last six Board meetings ➤ Board’s meeting schedule and Board committee meeting schedule ➤ Description of Board procedures. |
| Director’s Development | <p>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:</p> <ul style="list-style-type: none"> ➤ Ongoing education ➤ Site visits ➤ Seminars; and ➤ Various short term and long term Courses. |
| Familiarisation Programme for Independent Directors: | <p>Regulation 25(7) of SEBI (LODR) regulations, 2015 provides that the listed entity shall familiarise the independent directors through various programmes about the listed entity, including the following:</p> <ul style="list-style-type: none"> ➤ nature of the industry in which the listed entity operates; ➤ business model of the listed entity; ➤ roles, rights, responsibilities of independent directors; and ➤ any other relevant information. <p>Schedule IV of the Companies Act 2013 also provides that the Independent Directors shall undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company.</p> |
| Requirements under the Companies Act 2013 | <p>1. The Role of the Nominations and Remuneration Committee in performance evaluation of directors:</p> <p>Section 178 (2): The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and [shall specify the manner for effective evaluation of performance of Board, its committees and individual directors to be carried out either by the Board, by the Nomination and Remuneration Committee or by an independent external agency and review its implementation and compliance].</p> <p>2. Independent Directors’ role in performance evaluation of Boards, non-independent directors and Chairperson:</p> <p>The independent directors are required to hold at least one meeting</p> |

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| | <p>in a year, without the attendance of non-independent directors and members of the management and in that meeting they are required to review the performance of</p> <ul style="list-style-type: none"> ➤ the non-independent directors and ➤ the Board as whole; and ➤ also review the performance of the Chairperson of the company, taking into account the views of the executive and non-executive directors. <p>3. Performance evaluation of Independent Directors: the Board of every listed company and every other public company having paid- up share capital of twenty five crores or more calculated at the end of the preceding financial year except Government Companies has to do formal annual evaluation of the</p> <ul style="list-style-type: none"> ➤ Board ➤ its committees and ➤ all individual directors. <p>The Board’s report of such companies must include a statement indicating the manner & criteria of formal Board Evaluation.</p> <p>Provisions under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 It also requires Boards to conduct an annual performance evaluation and its disclosure in the annual report through the following provisions:</p> <ul style="list-style-type: none"> ➤ Regulation 17(10) mandates that entire board of directors shall do the performance evaluation of independent directors, provided that in the evaluation process, the directors who are subject to evaluation shall not participate. ➤ Regulation 19(4) read with Part D of Schedule II - It provides that the role of committee shall, inter-alia, include the following: <ul style="list-style-type: none"> • formulation of criteria for evaluation of performance of independent directors and the board of directors; • whether to extend or continue the term of appointment of the independent director, on the basis of the report of performance evaluation of independent directors. |
| <p>Frequency of Board Evaluation</p> | <p>Section 134(3)(p) provides that there has to be a formal annual evaluation of Board of its own performance and that of its committees and individual directors. The Company may undertake annual evaluation either in accordance with calendar year or financial year.</p> |

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| <p>Broad Evaluation framework and parameters</p> | <p>As per the Companies Act 2013 or SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Board evaluation would generally include following:</p> <ul style="list-style-type: none"> ➤ Evaluation of the Board as a whole ➤ Evaluation of the Committees ➤ Evaluation of Individual Directors <ul style="list-style-type: none"> • Managing Director / Whole time Director / Executive Director • Independent Directors • Non- executive Directors ➤ Evaluation of the Chairperson. <p>1. Evaluation of the Board as a whole:</p> <p>The evaluation of the performance of the Boards is essentially an assessment of how the Board has performed on following parameters which determines the effectiveness of boards.</p> <ul style="list-style-type: none"> ➤ Board Structure : its composition, constitution and diversity and that of its Committees, competencies of the members, Board and Committee charters, frequency of meetings, procedures; ➤ Dynamics and Functioning of the Board : annual Board calendar, information availability, interactions and communication with CEO and senior executives, Board agenda, cohesiveness and the quality of participation in Board meetings; ➤ Business Strategy Governance: Board’s role in company strategy; ➤ Financial Reporting Process, Internal Audit and Internal Controls: The integrity and the robustness of the financial and other controls regarding abusive related party transactions, vigil mechanism and risk management; ➤ Monitoring Role: Monitoring of policies, strategy implementation and systems; ➤ Supporting and Advisory Role; and ➤ The Chairperson’s Role. |
| <p>EVALUATION OF THE COMMITTEES</p> | <p>The evaluation may be externally facilitated. The broad parameters of reviewing the performance of the Committees, inter alia, are:</p> <ul style="list-style-type: none"> ➤ Discharge of its functions and duties as per its terms of reference; ➤ Process and procedures followed for discharging its functions; ➤ Effectiveness of suggestions and recommendations received; ➤ Size, structure and expertise of the Committee; and |

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| | <ul style="list-style-type: none"> ➤ Conduct of its meetings and procedures followed in this regard. |
| <p>EVALUATION OF INDIVIDUAL DIRECTOR(s)</p> | <p>Evaluation of Managing Director / Whole time Director / Executive Director: The broad parameters for reviewing the performance of Managing Director/ Executive Director are:</p> <ul style="list-style-type: none"> ➤ Achievement of financial/business targets prescribed by the Board; ➤ Developing and managing / executing business plans, operational plans, risk management, and financial affairs of the organization; ➤ Display of leadership qualities i.e. correctly anticipating business trends, opportunities, and priorities affecting the Company’s prosperity and operations; ➤ Development of policies, and strategic plans aligned with the vision and mission of Company and which harmoniously balance the needs of shareholders, clients, employees, and other stakeholders; ➤ Managing relationships with the Board, management team, regulators, bankers, industry representatives and other stakeholders. |
| <p>Evaluation of Independent Directors:</p> | <p>The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors. The company should disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report.</p> <p>Major Factors for Evaluation:</p> <ul style="list-style-type: none"> ➤ The quality of the issues that get raised, discussed and debated at the meetings of the Board and its Committees. ➤ The guidance provided by the Board in the light of changing market conditions and their impact on the organisation. ➤ The methodology adopted by the Board to solve issues referred to them ➤ The effectiveness of the directions provided by the Board on the issues discussed in meetings. <p>Parameters:</p> <ul style="list-style-type: none"> ➤ Exercise of objective independent judgment in the best interest of Company; ➤ Ability to contribute to and monitor corporate governance practice; and |

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| | <ul style="list-style-type: none"> ➤ Adherence to the code of conduct for independent directors. ➤ Performance of the Board against the benchmark performance set. ➤ Overall value addition by the discussions taking place at the Board meetings. |
| Evaluation of Non-Executive Directors | <p>The broad parameters for reviewing the performance of Non-executive Directors are:</p> <ul style="list-style-type: none"> ➤ Participation at the Board / Committee meetings; ➤ Commitment (including guidance provided to senior management outside of Board/ Committee meetings); ➤ Effective deployment of knowledge and expertise; ➤ Effective management of relationship with stakeholders; ➤ Integrity and maintaining of confidentiality; ➤ Independence of behaviour and judgment; and ➤ Impact and influence. |
| EVALUATION OF CHAIRPERSON OF THE BOARD | <p>The broad parameters for reviewing the performance of Chairperson of the Board are:</p> <ul style="list-style-type: none"> ➤ Managing relationship with the members of the Board and management; ➤ Demonstration of leadership qualities; ➤ Relationship and communication within the Board; ➤ Providing ease of raising of issues and concerns by the Board members; and ➤ Promoting constructive debate and effective decision making at the board; ➤ Relationship and effectiveness of communication with the shareholders and other stakeholders; ➤ Promoting shareholder confidence in the Board and ➤ Personal attributes i.e. Integrity, Honesty, Knowledge, etc. |
| BOARD EFFECTIVENESS AND THE ROLE OF THE COMPANY SECRETARY | <p>A Company Secretary acts as a vital link between the company and its Board of Directors, shareholders and other stakeholders and regulatory authorities. A Company Secretary is a close confidante of the board and commands confidence of individual directors so as to ensure that the culture of independence is promoted at the board and committee meetings and at the level of individual directors.</p> <p>Company Secretary:</p> |

- acts as a **vital link between the company and its Board of Directors**, shareholders and other stakeholders and regulatory authorities
- plays a **key role in ensuring that the Board procedures** are followed and regularly reviewed
- provides the Board with guidance **as to its duties, responsibilities and powers under various laws, rules and regulations**
- acts as a **compliance officer** as well as an in-house legal counsel to advise the Board and the functional departments of the company on various corporate, business, economic and tax laws
- is an important member of the **corporate management team** and acts as conscience keeper of the company.

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

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

BOARD EFFECTIVENESS INDICATORS

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

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

- Does at least one member of the board have extensive experience in the industry of your organization?
- **Are directors offered continuing education in governance or a program of director certification?**
- **Does each director display a keen interest or passion in the undertaking of the organization?**
- **Do directors regularly attend both board and committee meetings?**
- Are directors encouraged and supported when asking difficult or awkward questions of management?
- **Does the Chairman solicit views from each director specifically?**
- **Does the Chairman ask board members to refrain from expressing their personal views at the outset of a discussion?**
- **Does the board review the risk identification and management system of the organization?**
- **Does the board approve the business plan and major expenditures?**

- Does the board work with the CEO and senior staff to develop and review the strategic plan?

MODEL BOARD CHARTER

As a **good practice companies may have a Board Charter** which is intended as a tool to assist directors in fulfilling their **responsibilities as Board members**. It sets out the respective roles, responsibilities and authorities of the Board and of Management in the governance, management and control of the organization. **This charter should be read in conjunction with the Company's Memorandum and Articles.**

A Model Charter may include the following:

- The Role of the Board
- The Role of the CEO
- The Role of the Company Secretary
- Directors Code of Conduct
- Conflicts of Interests
- Related Party transactions
- Board Members Qualifications, skills
- Board Meetings
- Delegation of Authority by the Board
- Role & power of Committees
- Committee Meetings
- Protocol for media contact and comment
- Hospitality and Gifts
- Board Evaluation
- Directors liability insurance
- Director Induction
- Non-Executive Director Remuneration
- Reimbursement of expenses.

SOME EXAMINATION QUESTIONS

1. Should the role of Chairman and CEO be separated?
2. "A good practice is to designate an independent director as a Lead Independent Director".
Elucidate the role of Lead Independent Director according to Companies Act, 2013.
3. Write Short Notes on –
 - Board Composition
 - Training of Directors
 - Board Charter
 - Board Evaluation
 - Shadow Director
 - Succession Planning

CHAPTER 4
SECRETARIAL STANDARD 1

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| 1. Applicability of SS-1 | <ul style="list-style-type: none"> ➤ Every company is required to observe SS-1 except <ul style="list-style-type: none"> • One Person Companies(OPC) having only one Director on its Board and • Such other class or class of companies which are exempted by Central Government through Exemptions shall be applicable to a Section 8 company provided it has not committed a default in filing its Financial Statements or Annual Return with the Registrar of Companies. However, Section 8 companies need to comply with the applicable provisions of the Act relating to Board Meetings. |
| 2. Who will convene the Board meeting? | <ul style="list-style-type: none"> ➤ Subject to Articles of Association of a company, Board meeting may be convened by : <ul style="list-style-type: none"> • Any Director of a company • The Company Secretary or where there is no Company Secretary, any person authorized by the Board in this behalf, on the requisition of a Director. • The Company Secretary cannot summon a Meeting on his own, unless authorized by the Board of Directors or the Articles to do so. |
| 3. What are the modes of sending notice? | <ul style="list-style-type: none"> ➤ Notice in writing of every Meeting shall be given to every Director by hand or by speed post or by registered post or by facsimile or by e-mail or by any other electronic means.[Courier excluded] |
| 4. What are the essentials of notice? | <ul style="list-style-type: none"> ➤ The Notice shall specify the serial number, day, date, time and full address of the venue of the Meeting. ➤ The Notice should specify the serial number given to the Meeting. ➤ Day and date specified in the Notice should be as per the Gregorian calendar. ➤ The time specified in the Notice should be the time of commencement of the Meeting. ➤ Notice shall seek advance confirmation from directors asto whether they will participate. |
| 5. It is mandatory to give notice? | <ul style="list-style-type: none"> ➤ The Notice of a Meeting shall be given even if meetings are held on predetermined dates or at pre-determined intervals. |
| 6. Whether any item not mention in agenda can be taken up for discussion? | <ul style="list-style-type: none"> ➤ Any item not included in the Agenda may be taken up for consideration with the permission of the Chairman and with the consent of a majority of the Directors present in the Meeting. |
| 7. What is the frequency | <ul style="list-style-type: none"> ➤ The company shall hold at least four Meetings of its Board |

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| of Board meeting? | in each Calendar Year with a maximum interval of one hundred and twenty days between any two consecutive Meetings. |
| 8. What is the frequency of Board meeting for Opc ,Small, Dormant company? | ➤ It shall be sufficient if a One Person Company, Small Company or Dormant Company holds one Meeting of the Board in each half of a calendar year and the gap between the two Meetings of the Board is not less than ninety days. If a One Person Company, Small Company or Dormant Company holds only two Meetings in a year, then the gap between the two such Meetings should be minimum 90 days. |
| 9. Whether SS1 applicable to Independent director Meeting ? | ➤ A Meeting of Independent Directors is not a Meeting of the Board or of a Committee of the Board. Therefore, provisions of SS-1 shall not be applicable to such Meetings. |
| 10. Whether interested director can participate in Board meeting in case of Private company . | ➤ An Interested Director should neither participate nor vote in respect of an item in which he is interested, nor such Director be counted for Quorum in respect of such item. However, such Director may be present in the Meeting during discussions on such item. However, in case of a private company, a Director shall be entitled to participate in respect of such item after disclosure of his interest. |
| 11. What are the requirements of quorum for committees meeting? | ➤ Unless otherwise stipulated in the Act or the Articles or under any other law, the Quorum for Meetings of any Committee constituted by the Board shall be as specified by the Board. If no such Quorum is specified, the presence of all the members of any such Committee is necessary to form the Quorum. |
| 12. Do the recording of “Invitees” or “in Attendance” mandatory? | ➤ Persons who are present in a Meeting merely to provide administrative assistance to an Invitee or Director or Company Secretary should neither be treated as “Invitees” nor as “in Attendance”. The Chairman may use his discretion in recording the presence of such persons. |
| 13. When the director is required to vacant the office? | ➤ The office of a Director shall become vacant in case the Director absents himself from all the Meetings of the Board held during a period of twelve months with or without seeking leave of absence of the Board. |
| 14. What is the procedure for Election of Chairman in the absence of elected chairman? | ➤ If no Chairman is elected by the Board, or if at any Meeting, the Chairman is not present within five minutes after the time appointed for holding the Meeting, the Directors present may choose one of their number to be Chairman of the Meeting. |
| 15. Can interested chairman continue to chair in interested matters? | ➤ If the Chairman is interested in an item of business, he shall entrust the conduct of the proceedings in respect of such item to any Non-Interested Director with the consent of the majority of Directors present and resume the Chair |

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| | <p>after that item of business has been transacted.</p> <ul style="list-style-type: none"> ➤ However, in case of a private company, the Chairman may continue to chair and participate in the Meeting after disclosure of his interest. If the item of business is a related party transaction, the Chairman shall not be present at the Meeting, whether physically or through Electronic Mode, during discussions and voting on such item. |
| 16. Are minutes exhaustive records? Who shall record it? | <ul style="list-style-type: none"> ➤ Minutes need not be an exact transcript of the proceedings at the Meeting. ➤ The Company Secretary shall record the proceedings of the Meetings. Where there is no Company Secretary, any other person duly authorised by the Board or by the Chairman in this behalf shall record the proceedings. ➤ In case a Company Secretary is unable to attend a Meeting, or in the absence of the Company Secretary, any other person duly authorised by the Board or by the Chairman may attend and record the proceedings of the Meeting. |
| 17. Is it mandatory to record each and every matter in minute book? | <ul style="list-style-type: none"> ➤ The Chairman has absolute discretion to exclude from the Minutes, matters which in his opinion are or could reasonably be regarded as defamatory of any person, irrelevant or immaterial to the proceedings or which are detrimental to the interests of the company. |
| 18. What is the procedure for modification of earlier resolution? | <ul style="list-style-type: none"> ➤ Where any earlier Resolution(s) or decision is superseded or modified, Minutes shall contain a specific reference to such earlier Resolution(s) or decision or state that the Resolution is in supersession of all earlier Resolutions passed in that regard. |
| 19. Procedure for resolution by circulation? | <ul style="list-style-type: none"> ➤ The Chairman of the Board or in his absence, the Managing Director or in their absence, any Director other than an Interested Director, shall decide, before the draft Resolution is circulated to all the Directors, whether the approval of the Board for a particular business shall be obtained by means of a Resolution by circulation. ➤ In case one-third of the total number of Directors for the time being require the Resolution under circulation to be decided at a Meeting, the Chairman shall put the Resolution for consideration at a Meeting of the Board. ➤ Draft Resolution together with necessary documents is sent to all directors, including interested director by hand / speed post / courier / registered post/ e-mail / other electronic means; <ul style="list-style-type: none"> • Each resolution shall carry a serial number; • Each Resolution shall be explained separately containing: <ul style="list-style-type: none"> • Details of proposal; • Material facts; |

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| | <ul style="list-style-type: none"> • Scope and implications; • Nature of concern or interest of Directors; • How a Director shall give his assent or dissent; and • Time within which Directors shall signify his assent or dissent <p>➤ By majority of directors entitled to vote. Directors shall signify their assent or dissent by signing the Resolution to be passed by circulation or by e-mail or any other electronic means.</p> |
| 20. Mention the time limit for finalisation of minutes? | <p>➤ Within fifteen days from the date of the conclusion of the Meeting of the Board or the Committee, the draft Minutes thereof shall be circulated by hand or by speed post or by registered post or by courier or by e-mail or by any other recognised electronic means to all the members of the Board or the Committee, as on the date of the Meeting, for their comments.</p> <p>➤ Only if Chairman is authorized by the Board, he has discretionary power to consider the comments of any director received after expiry of seven days from the date of dispatch of draft minutes to them.</p> |
| 21. What is the procedure for alteration of minutes once entered in the Minutes Book? | <p>➤ Minutes, once entered in the Minutes Book, shall not be altered.</p> <p>➤ Any alteration in the Minutes as entered shall be made only by way of express approval of the Board at its subsequent Meeting at which the Minutes are noted by the Board and</p> <p>➤ The fact of such alteration shall be recorded in the Minutes of such subsequent Meeting.</p> |
| 22. Who will for signing and dating of minutes? | <p>➤ Minutes of the Meeting of the Board shall be signed and dated by the Chairman of the Meeting or by the Chairman of the next Meeting.</p> |
| 23. Can proxies be appointed to attend board meeting? | <p>➤ Proxies cannot be appointed to attend Board Meetings. As the Act does not contain any provision conferring on the Directors the right to appoint a proxy to attend Board Meetings.</p> |
| 24. Within what time loose leaf of minutes of board meeting be bound? | <p>➤ Minutes of the Board Meetings, if maintained in loose-leaf form, should be bound periodically depending on the size and volume, coinciding with the financial year(s) of the company.</p> |
| 25. What is the time limit for preservation of minutes and other records? | <p>➤ Minutes of all meetings shall be preserved permanently in physical or in electronic form with timestamp.</p> |
| 26. Can a BM be held at any place? | <p>➤ REVISED SS-1 Board Meeting can be held at any time (even outside INDIA), any place and any day.</p> <p>➤ Can be held even on national holiday. But adjourned board</p> |

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| | meeting cannot be held on national holiday. |
| 27. Proof of sending the notice. | ➤ Proof of sending the notice and its delivery shall be maintained by the Company for a period of ATLEAST 3 YEARS. |

SECTION 173 MEETING OF THE BOARD OF DIRECTORS

- (1) *Every company shall hold the first meeting of the Board of Directors WITHIN 30 DAYS of the date of its incorporation and thereafter hold a minimum number of FOUR MEETINGS of its Board of Directors every year in such a manner that not more than 120 DAYS shall intervene between two consecutive meetings of the Board:*

Provided that the Central Government may, by notification, direct that the provisions of this subsection shall not apply in relation to any class or description of companies or shall apply subject to such exceptions, modifications or conditions as may be specified in the notification.

Exception: Number of Board Meetings is different from OPC, Small Company, Dormant Company – Sec 173(5)

Further in respect of Section 8 companies, this subsection shall apply only to the extent that the Board of Directors of such companies shall hold at least one meeting within every six calendar months.

Frequency of Meetings as per Secretarial Standard-I:-

The Board should meet at least once in every three months, with a maximum interval of 120 days between any two Meetings such that at least four Meetings are held in each year.

Meetings of Committees:-

Committees should meet at least as often as stipulated by the Board or as prescribed by any other authority.

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| 1 | X ltd. Conducted its BM on following dates, Is it complying with law? |
| | 1st Jan, 1st June, 1st July, 1st Dec. |

- (2) The participation of directors in a meeting of the Board may be either in person or through video conferencing or other audio visual means, as may be prescribed, which are capable of recording and recognising the participation of the directors and of recording and storing the proceedings of such meetings along with date and time:

Meetings of Board through video conferencing or other audio visual means. - PROCEDURE:

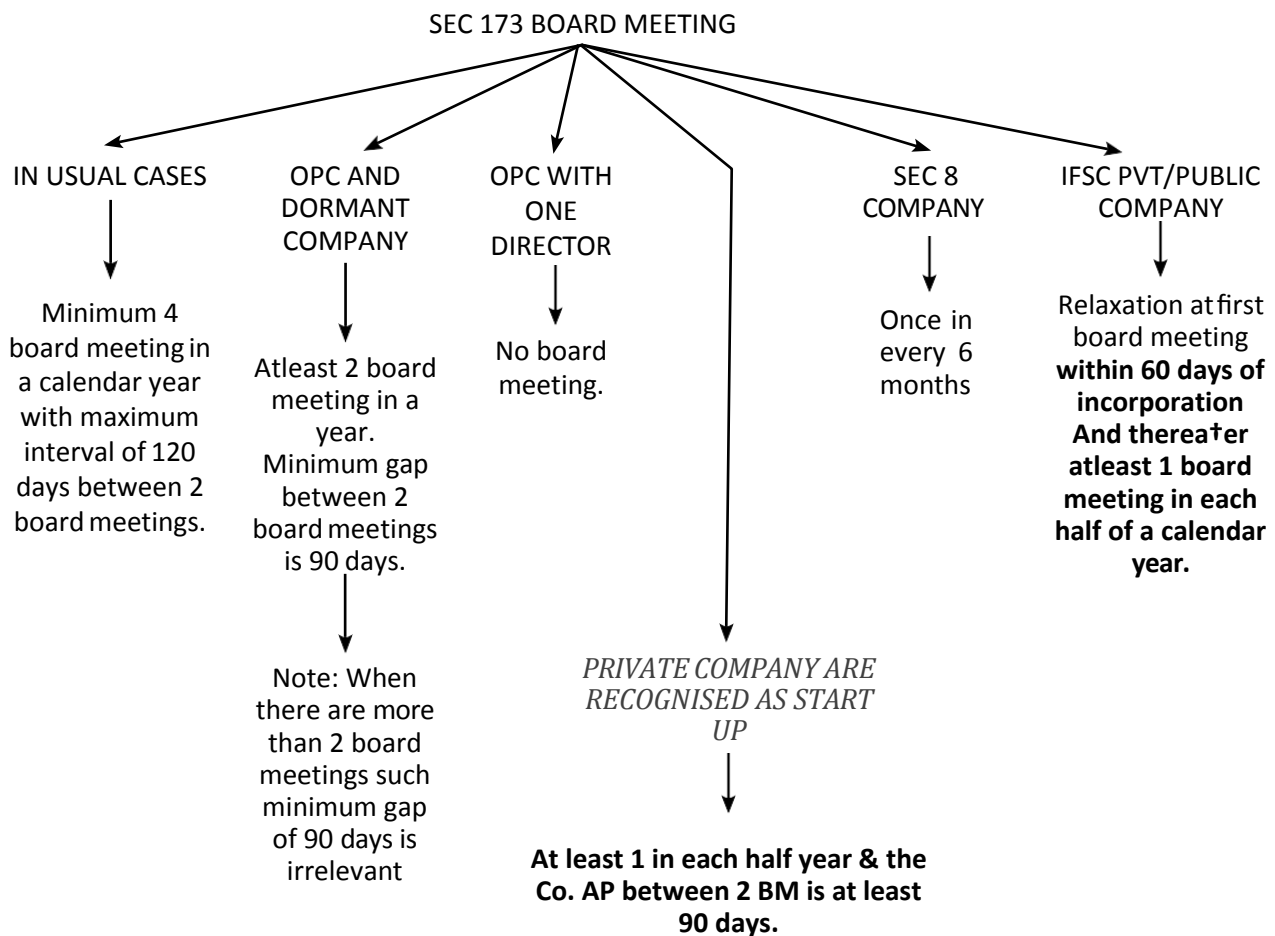
A company shall comply with the following procedure, for convening and conducting the Board meetings through video conferencing or other audio visual means.

D *Every Company shall make necessary arrangements to avoid failure of video or audio visual connection.*

D *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 availability of proper video conferencing or other audio visual equipment or facilities for providing transmission of the communications for elective participation of the directors and other authorised participants at the Board meeting;*
- (c) *to record 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 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:
 Provided that the persons, who are differently abled, may make request to the Board to allow a person to accompany him.





Can be held even on national holiday.

But adjourned board meeting cannot be held on national holiday.

Note :- REVISED SS-1 NOTICE OF ADJOURNED BOARD MEETING

Example:- Company incorporated on 01-10-2018, 1st Board meeting within 30 days

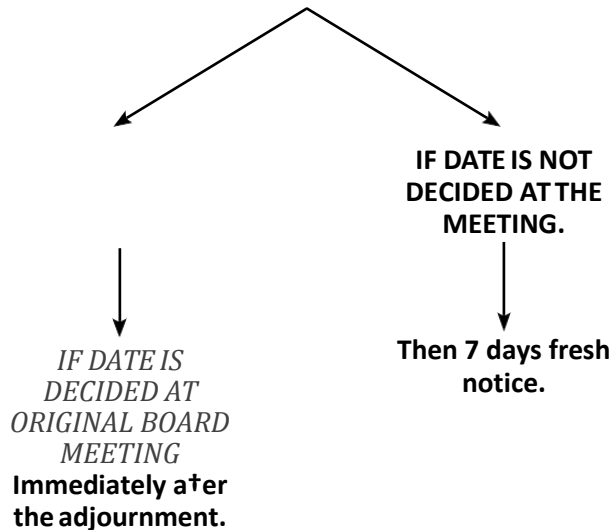
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|  1 | TIME, PLACE, DAY OF BOARD MEETING? |
|  | REVISED SS-1 Board Meeting can be held at any time (even outside INDIA),any place and any day. |

Can be held even on national holiday.



But adjourned board meeting cannot be held on national holiday.

Note :- 1. First Board Meeting To Be Held Within 30 Days Of Incorporation.

2. REVISED SS-1 NOTICE OF ADJOURNED BOARD MEETING



3. Proof of sending notice /agenda/notes /minutes and DELIEVERY shall be maintained by company for atleast 3 years from the date of meeting.
4. Agenda-list of items.Act is silent about the despatch of agenda.
BUT REVISED SS-1 (1.10.2017) agenda ,notes to be sent to all directors by.....COURIER NOT ALLOWED.

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|---|---|
|  1 | Who can attend BM? |
|  | <p>1. Directors</p> <p>2. Persons invited by Directors about the proposed agenda.</p> <p>Add EX 1 If BM is on 8th Aug .Notice should be given on 1st.Only date of BM excluded.</p> <p>But if notice of BM is through post then two more days are excluded .If meeting is on 18th then notice shall be given by 9th.</p> |

1st August, 2,3,4,5,6,7,8th August

Only Date of BM is excluded if notice is given by mail/fax.

If the date is given by post then two more dates excluded

9,10,11,12,13,14,15,16,17,18

X, X , X

NOTICE

- Q **The notice of the meeting shall be sent to all the directors** in accordance with the provisions of subsection (3) of section 173 of the Act. Provided further that where there is quorum in a Meeting through Physical Presence of Directors, any other Director may participate through Video-Conferencing or other Audio - Visual means. In such Meeting on any matter specified under first proviso.
- Q **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.
- Q A **director intending to participate through video conferencing** or audio visual means **shall communicate his intention to the Chairperson or the company secretary** of the company.
- Q 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 arrangements in this behalf provided that such declaration shall not debar him from participation in the meeting in person in which case he shall intimate the company sufficiently in advance of his intention to participate in person.
- Q 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.
- Q In the absence of any intimation under clause (c), it shall be assumed that the director shall attend the meeting in person.

PROCEEDINGS DURING THE MEETING:

- Q At the **commencement of the meeting**, a **roll call shall** be taken by the Chairperson when every director participating through video conferencing or other audio visual means shall state, for the record, the following namely:-
- (a) name;
 - (b) the location from where he is participating;
 - (c) that he has received the agenda and all the relevant material for the meeting; and
 - (d) that no one other than the concerned director is attending or having access to the proceedings of the meeting at the location mentioned in clause (b);
- Q **After the roll call, the Chairperson or the Company 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 Chairperson and confirm that the required quorum is complete.
- Q Explanation. - **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. In RPT transaction a director cannot vote**
- Q The Chairperson shall **ensure that the required quorum** is present **throughout** the meeting. With respect to every meeting conducted through video conferencing or other audio visual means authorised under these rules, **the scheduled venue of the meeting** as set forth in the notice convening the meeting, **shall be deemed to be the place of the said meeting** and all recordings of the proceedings at the meeting shall be deemed to be made at such place. **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. Every **participant shall identify himself for the record before speaking** on any item of business on the agenda.

Q 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.

Q 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.

From the commencement of the meeting and until the conclusion of such meeting, **no person other than the Chairperson, Directors, Company 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.**

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, who dissented from the decision taken by majority.

Act is silent about the time of signing minutes of BM by the CHAIRMAN

MINUTES

The **minutes shall disclose the particulars of the directors who attended** the meeting through video conferencing or other audio visual means.

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.

Every director who attended the meeting, whether personally or through video conferencing or other audio visual means, **shall confirm or give his comments** in writing, 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.

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.

4 Physically

Example: 7 Directors present (quorum=5)

3 Video conferencing

In the meeting merger proposal was to be discussed.

Ans: Here Quorum should be physically present. Matters can't be discussed as physical quorum is not present.

MATTERS NOT TO DEALT THROUGH VIDEO CONFERENCE:

Provided that the Central Government may, by notification, **specify such matters** which shall NOT BE DEALT WITH IN A MEETING THROUGH VIDEO CONFERENCE or other audio visual means. The matters are as follows:

Q the approval of the annual financial statements;

Q the approval of the Board's report;

Q the approval of the prospectus;

Q the Audit Committee Meetings for consideration of financial statement including consolidated, if any; and

Q the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

Provided further that where there is a quorum in a meeting through physical presence of directors, any other director may participate through video conferencing or other audio visual means in such meeting on any matter specified under the first proviso.

- (3) A meeting of the Board shall be called by giving **not less than seven days' notice** in writing to **every director at his address registered** with the company and such notice shall be sent **by hand delivery or by post or by electronic means**:

Provided that a meeting of the Board may be called at **shorter notice to transact urgent business subject to the condition that AT LEAST ONE INDEPENDENT DIRECTOR, if any, shall be present at the meeting**:

Provided further that in **case of absence of independent directors** from such a meeting of the Board, **decisions taken** at such a meeting shall be circulated to all the directors and **shall be final only on ratification thereof by at least one independent director, if any**.

Notice of a Board Meeting (Sec. 173 of the Companies Act, 2013)

| | |
|--|--|
| <p>Length of Notice</p> <p>A director may summon and the CS on the requisition of a director can convene a board Meeting after consulting chairman/MD/WD in absence of the chairman.</p> | <p>(a) At least 7 days notice is required</p> <p>(b) Shorter notice is valid, if –</p> <div style="border: 1px solid black; padding: 2px; display: inline-block; margin-right: 10px;">Urgent matter</div> and <div style="border: 1px solid black; padding: 2px; display: inline-block; margin-right: 10px;">Present in BM : At least 1 independent director, if any</div> <p style="text-align: center;">Otherwise</p> <div style="border: 1px solid black; padding: 2px; text-align: center; margin: 0 auto; width: 80%;">Decision circulated to all the directors</div> <p style="text-align: center;">and</p> <div style="border: 1px solid black; padding: 2px; text-align: center; margin: 0 auto; width: 80%;">Decision ratified by at least 1 independent director, if any</div> |
|--|--|

- (4) Every officer of the company whose duty is to give notice under this section and who fails to do so shall be liable to a penalty of twenty-five thousand rupees.

NUMBER OF MEETING FOR OPC, SMALL COMPANY, DORMANT COMPANY

- (5) A One Person Company, small company and dormant company shall be deemed to have complied with the provisions of this section if **at least one meeting** of the Board of Directors has been conducted **in each half of a calendar year** and the **gap between the two meetings is not less than ninety days**:

Provided that nothing contained in this sub-section and in section 174 shall apply to **One Person Company** in which there **is only one director** on its Board of Directors.

Ex :- Yash Raj Pvt. Ltd. :- Paid up share capital - 40 lakhs. Turnover - 1 Crore.

Ans. :- This is a small Co. so compliance of section 173(5) will be there.

Case - 1. If OPC has only 1 director.

According to sec- 122, any board resolution to be placed in the board minutes and the date mentioned therein shall be deemed to be date of board meeting.

SECTION 174 QUORUM FOR MEETINGS OF BOARD

- (1) *The quorum for a meeting of the Board of Directors of a company shall be one-third of its total strength or two directors, whichever is HIGHER, and the participation of the directors by video conferencing or by other audio visual means shall also be counted for the purposes of quorum under this sub-section. Refer Numerical.*

Also refer SEBI LODR

- (2) The continuing directors may act notwithstanding any vacancy in the Board; but, if and so long as their number is reduced below the quorum fixed by the Act for a meeting of the Board, the continuing directors or director may act for the purpose of increasing the number of directors to that fixed for the quorum, or of summoning a general meeting of the company and for no other purpose.

Quorum should be present throughout the meeting

Quorum for meeting of the Board of section 8 companies shall be: -

- (a) 8 members
- (b) 25% of total strength of the Board

Whichever is less

In any case, the quorum shall not be less than 2 members

Quorum of Producer Co. 1/3 OR 3 whichever is higher

DISINTERESTED QUORUM

- (3) Where 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 directors and present at the meeting, being not less than two, shall be the quorum during such time.

Explanation -For the purposes of this sub-section, "interested director" means a director within the meaning of sub-section (2) of section 184.

- (4) Where a meeting of the Board could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned to the same day at the same time and place in the next week or if that day is a national holiday, till the next succeeding day, which is not a national holiday, at the same time and place.

Explanation.--For the purposes of this section,--

- (a) any fraction of a number shall be rounded off as one;
- (b) "total strength" shall not include directors whose places are vacant.

| | |
|-----|--|
| 💡 1 | Total Directors = 12; All 12 came; Interested Directors = 9 |
| | Is Q present? |
| ☰ | Q should be $1/3 \times 12$ OR 2 -higher |
| | Actual Directors 12 |
| | Interested Directors 9 |
| | Disinterested 3 Not present |
| | Exception: |
| | If no. of ID $\geq 2/3$ of total strength |
| | Then remaining disinterested directors (at least 2) forms the quorum |

BOARD MEETING

| | Time of Preparing M | Time of Signing M | who signs |
|----|---------------------|--------------------------|----------------------------|
| GM | 30 days | 30 | C/D duly authorized by BOD |
| BM | 30 days | No Time mentioned in Act | C/C of succeeding meeting |

SECTION 175

PASSING OF RESOLUTION BY CIRCULATION

(1) No resolution shall be deemed to have been duly passed by the Board or by a committee thereof by circulation, unless the resolution has been circulated in draG, together with the necessary papers, if any, to all the directors, or members of the committee, as the case may be, at their addresses registered with the company in India by hand delivery or by post or by courier, or through such electronic means which may include E-mail or fax AND has been approved by a majority of the directors or members, who are entitled to vote on the resolution:

Provided that, where not less than one-third of the total number of directors of the company for the time being require that any resolution under circulation must be decided at a meeting, the chairperson shall put the resolution to be decided at a meeting of the Board.

(2) A resolution under sub-section (1) shall be noted at a subsequent meeting of the Board or the committee thereof, as the case may be, and made part of the minutes of such meeting.

Passing Resolution by Circulation (Sec. 175 of the Companies Act, 2013)

| | | |
|--|--|--|
| Conditions for passing a resolution by circulation | Circulate (a) DraG resolution (b) Necessary papers (if any) - to all the directors - at their registered address - by hand delivery/post courier / e-mail / fax | + Approval by majority of all the directors who are entitled to vote |
| Resolution not to be passed by circulation | 1/3rd of the total number of directors require that the resolution be decided at BM | Effect : Resolution shall not be passed by circulation |
| Other points | Resolution passed by circulation → Subsequent BM | <ul style="list-style-type: none"> • Noted • Included in minutes |

SECTION 176

DEFECTS IN APPOINTMENT OF DIRECTORS NOT TO INVALIDATE ACTIONS TAKEN

No act done by a person as a director shall be deemed to be invalid, notwithstanding that it was subsequently noticed that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in this Act or in the articles of the company:

Provided that nothing in this section shall be deemed to give validity to any act done by the director after his appointment has been noticed by the company to be invalid or to have terminated.

Note: Revised SS 1 The chairman of the BOD/ in absence of chairman any director (other than interested director) shall decide that matter can be decided by CIRCULATION.

**CHAPTER 5
Board Committees**

A board committee is a small working group identified by the board, consisting of board members, for the purpose of supporting the board's work. Committees are usually formed as a means of improving board effectiveness and efficiency, in areas where more focused, specialized and technical discussions are required. **Committees thus have an important role :**

- **To strengthen the governance arrangements of the company and support the Board in the achievement of the strategic objectives of the company.**
- **To strengthen the role of the Board in strategic decision making and supports the role of non-executive directors in challenging executive management actions.**
- **To maximise the value of the input from non-executive directors, given their limited time commitment.**
- **To support the Board in fulfilling its role, given the nature and magnitude of the agenda.**

COMMITTEE MANAGEMENT

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

MANDATORY COMMITTEES OF THE BOARD

| Companies Act, 2013 (for certain class of companies) | SEBI (LODR) Regulations, 2015 (for listed companies) |
|---|--|
| <ul style="list-style-type: none"> ➤ Audit Committee Nomination ➤ Nomination and Remuneration Committee ➤ Stakeholders Relationship Committee Corporate ➤ Social Responsibility Committee | <ul style="list-style-type: none"> ➤ Audit Committee ➤ Nomination and Remuneration Committee ➤ Stakeholders Relationship Committee ➤ Risk Management Committee |

**SECTION 177
AUDIT COMMITTEE**

- (1) The Board of Directors of **every listed Public company** and following companies, shall constitute an Audit Committee.

The board of directors of every listed company and a company covered under rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 shall constitute an "Audit Committee" and a "Nomination and Remuneration Committee of the Board"

If a company is not required to appoint independent director then no need to constitute such committee

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.

NUMBER OF DIRECTORS REQUIRED



- (2) **The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority:**

Provided that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.

In listed companies at least 2/3rd will be independent directors as per Clause 49 of Listing Agreement. Further Audit committee in case of Section 8 companies can be formed without independent directors.

FUNCTIONS OF COMMITTEE

- (4) Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include,--
 - (a) **the recommendation for appointment, remuneration and terms of appointment of auditors of the company;**
(appointment and terms of appointment shall not be the part of terms of reference of audit committee in case of Government Companies)
 - (b) **review and monitor the auditor's independence and performance, and effectiveness of audit process;**
 - (c) **examination of the financial statement and the auditors' report thereon;**
 - (d) *approval or any subsequent modification of transactions of the company with related parties;*

| | |
|--|--|
|  41 | <p>X Ltd</p> <hr style="width: 50%; margin: auto;"/> <p>unlisted public co. ID at least 2</p> <p>Audit Committee — 5 directors Co is having 2 ID</p> |
|  | <p>149</p> <p>177 here No. of ID</p> <p>Should be 3 to Comply with 177</p> |

Provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed. Provided further that in case of transaction, other than transactions referred to in section 188 and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board;

Provided also that in case any transaction involving any amount not exceeding one crore rupees is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it :

Provided also that the provisions of this clause shall not apply to a transaction, other than a transaction referred to in section 188, between a holding company and its wholly owned subsidiary company.

- (e) scrutiny of inter-corporate loans and investments;
 - (f) valuation of undertakings or assets of the company, wherever it is necessary;
 - (g) evaluation of internal financial controls and risk management systems;
 - (h) monitoring the end use of funds raised through public offers and related matters.
- (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 **shall have authority to investigate** into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.
- (7) The **auditors of a company and the key managerial personnel** shall have a right to be **heard in the meetings of the Audit Committee** when it considers the auditor's report but shall not have the right to vote.
- (8) **The Board's report under sub-section (3) of section 134 shall disclose the composition of an Audit Committee** and where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in such report along with the reasons therefor.
- (9) **Every listed company or the Companies which accept deposits from banks or the Companies the public financial institutions in excess of fifty crore rupees, shall ESTABLISH A VIGIL MECHANISM FOR DIRECTORS AND EMPLOYEES** to report genuine concerns in such manner as may be prescribed.
- (10) The **vigil mechanism** under sub-section (9) shall **provide for adequate safeguards against victimization of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases:**
- Provided that the **details of establishment of such mechanism** shall be disclosed by the **company on its website**, if any, and **in the Board's report**.

SET UP OF VIGIL MECHANISM:

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

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 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.

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.

| | | |
|---|---|---|
| Manners of Establishment of Vigil Mechanism | <p>Case 1 : The company is required to constitute an audit committee</p> <p>↓</p> <p>Audit committee shall oversee the vigil mechanism</p> | <p>Case II : The company is not required to constitute an audit committee</p> <p>↓</p> <p>Board shall nominate a director to play the role of audit committee</p> |
| | <p>If any member of Audit Committee has a conflict of interest in a given case →</p> <ul style="list-style-type: none"> • Such member shall recuse himself • Other member shall deal with such matter | |
| | <p>Requires frivolous complaints → Suitable action including reprimanding such person</p> | |
| | <p>Website, if any + Board's Report</p> | |

SECTION 178 NOMINATION AND REMUNERATION COMMITTEE AND STAKEHOLDERS RELATIONSHIP COMMITTEE (Not applicable to Section 8 companies)

(1) The Board of Directors of **EVERY LISTED PUBLIC COMPANY** and following companies, shall constitute the **Nomination and Remuneration Committee** consisting of **THREE OR MORE NONEXECUTIVE DIRECTORS** out of which **not less than one-half shall be independent directors** :

The board of directors of every listed company and a company covered under rule 4 of the Companies (Appointment and Qualification of Directors) Rules,2014 shall constitute an "Audit Committee" and a "Nomination and Remuneration Committee of the Board"

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.

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

FUNCTION OF COMMITTEE

(2) **The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall specify the manner for effective evaluation of performance of Board, its committees and individual directors to be carried out either by the Board, by the Nomination and Remuneration Committee or by an independent external agency and review its implementation and compliance.**

(3) The Nomination and Remuneration Committee **shall formulate the criteria for determining qualifications, positive attributes and independence of a director** and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees.

(4) The Nomination and Remuneration Committee shall, while formulating the policy under subsection (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 placed on the website of the company, if any, and the salient features of the policy and changes therein, if any, along with the web address of the policy, if any, shall be disclosed in the Board's report.

STAKEHOLDERS RELATIONSHIP COMMITTEE (>=1001)

(5) **The Board of Directors of a company which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board.**

(6) **The Stakeholders Relationship Committee shall consider and resolve the grievances of security holders of the company.**



No Min. No of directors specified

COMMITTEE CHAIRMAN TO ATTEND THE GENERAL MEETING(S)

- (7) 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.**
- (8) In case of any contravention of the provisions of section 177 and this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to 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 one year or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both:

Provided that inability to resolve or consider any grievance by the Stakeholder Relationship Committee in good faith shall not constitute a contravention of this section.

Explanation – The expression “senior management means personnel of the company who are members of its core management team excluding Board of Directors comprising all members of management one level below the executive directors, including the functional heads.

As per SS-I all members of committee shall form Quorum of Meeting unless Board stipulates a different requirements while forming the committee

COMMITTEE FORMATION UNDER THE ACT:

| | Listed Company | Public Company | | | Company |
|--|----------------|------------------|-------------------|---------------------|--|
| | | Paid up Capital | Turnover | Loans or Borrowings | No. of Shareholders or Debenture holders |
| | | 10 crore or more | 100 crore or more | > 50 crore | > 1000 |
| Nomination and remuneration Committee (3 or more non-executive Directors with majority independent) | Yes | Yes | Yes | Yes | No |
| Audit Committee (minimum of 3 Directors with majority Independent) If listed co. then at least 2/3 ID | Yes | Yes | Yes | Yes | No |
| Stakeholder Relationship Committee (Chairman shall be non executive Director) | Yes | No | No | No | Yes |

| | |
|--------------------|------------------------|
| SECTION 179 | POWERS OF BOARD |
|--------------------|------------------------|

- (1) 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 :

Provided **that in exercising such power or doing such act or thing**, the Board shall be **subject to the provision contained in that behalf in this act**, or in the memorandum or articles, or in any regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in general meeting:

Provided further that the Board **SHALL NOT EXERCISE ANY POWER** or do any act or thing which is directed or required, whether under this Act or by the memorandum or articles of the company or otherwise, **to be exercise or done by the company in general meeting**

- (2) **No regulation** made by the company in general meeting **shall invalidate any prior act of the Board** which would have been valid if that regulation had not been made.

POWERS EXERCISABLE ONLY AT BOARD MEETING:

- (3) The **Board of Directors of a company** shall **exercise** the following powers on behalf of the company by means of resolutions **passed at meetings of the Board**, namely:
- (a) to make calls on shareholders in respect of money unpaid on their shares;
 - (b) to authorise buy-back of securities under section 68;
 - (c) to issue securities, including debentures, whether in or outside India;
 - (d) to borrow monies;
 - (e) to invest the funds of the company;
 - (f) to grant loans or give guarantee or provide security in respect of loans;
 - (g) to approve financial statement and the Board's Report;
 - (h) to diversify the business of the company;
 - (i) to approve amalgamation, merger or reconstruction;
 - (j) to take over a company or acquire a controlling or substantial stake in another company;
 - (k) following matters also as prescribed by the Rules:
 - *to make political contributions;*
 - **to appoint or remove key managerial personnel (KMP);**
 - **to take note of appointment(s) or removal(s) of one level below the Key Management Personnel; (NOW REMOVED)**
 - **to appoint internal auditors and secretarial auditor;**
 - **to take note of the disclosure of director's interest and shareholding; (NOW REMOVED)**
 - **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; (NOW REMOVED)**
 - **to invite or accept or renew public deposits and related matters; (NOW REMOVED)**
 - **to review or change the terms and conditions of public deposit; (NOW REMOVED)**

- **to approve quarterly, half yearly and annual financial statements or financial results as the case may be. (NOW REMOVED)**

Provided that matters referred to in clauses (d), (e), (f), of subsection (3) may be decided by the Board by circulation instead of at a meeting.

Provided that 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 the company, the principal officer of the branch office, the **power specified in clauses (d) to (f) on such conditions** as it may specify:

Provided further that the acceptance by a banking company in the ordinary course of its business of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draG, order or otherwise, or the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe, **shall not be deemed to be a borrowing of monies** or, as the case may be, a making of loans by a banking company within the meaning of this section.

In case of Section 8 companies Power to borrow monies; power to invest the funds of the company; and power to grant loans or give guarantee or provide security in respect of loans may be exercised by the Board by way of circular resolution.

Explanation I.--Nothing in clause (d) shall apply to borrowings by a banking company from other banking companies or from the Reserve Bank of India, the State Bank of India or any other banks established by or under any Act.

Explanation II.--In respect of dealings between a company and its bankers, the exercise by the company of the power specified in clause (d) shall mean the arrangement made by the company with its bankers for the borrowing of money by way of overdraG or cash credit or otherwise and not the actual day-to-day operation on overdraG, cash credit or other accounts by means of which the arrangement so made is actually availed of.

Nothing in this section shall be deemed to affect the right of the company in general meeting to impose restrictions and conditions on the exercise b

CORPORATE SOCIAL RESPONSIBILITY COMMITTEE

Section 135 (1) read with rule 3 of Companies (Corporate Social Responsibility Policy) Rules, 2014, mandates that every company which fulfils any of the following criteria during any of the three preceding financial years shall constitute a CSR Committee –

- Companies having **net worth of rupees five hundred crore or more, or**
- Companies having **turnover of rupees one thousand crore or more or**
- Companies having a **net profit of rupees five crore or more.**

Composition of the Committee

- The CSR Committee shall consist of **three or more directors.**
- At least **one director shall be an independent director.**
- Companies (Meetings of Board and Powers) Rules, 2014, however, provides that-
 - an **unlisted public company or a private company** covered under sub-section (1) of section 135 which is **not required to appoint an independent director**, shall have its CSR Committee without such director.
 - a **private company having only two directors** on its Board shall constitute its CSR Committee with **two such directors:**
 - with respect to a foreign company covered under these rules, the CSR Committee shall comprise of **at least two persons of which one person** shall be as specified under clause (d) of subsection (1) of section 380 of the Act ,i.e. the **person resident in India authorized to accept on behalf of the company**, service of process and any notices or other documents and another person shall be nominated by the foreign company.
 - **The composition of the CSR Committee shall be disclosed in the Board's Report**

Functions

section 135 the functions of the CSR committee include:

- **formulating and recommending to the Board, a CSR Policy** which shall indicate the activities to be undertaken by the company as specified in Schedule VII;
- **recommending the amount of expenditure** to be incurred on the CSR activities.
- **monitoring the Corporate Social Responsibility Policy** of the company from time to time.
- Further the rules provide that the **CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.**

RISK MANAGEMENT COMMITTEE

Under SEBI (LODR) Regulations, 2015 Regulation 21 of the SEBI (LODR) 2015 deals with the Risk Management Committee and provides as under:

- The board of directors shall constitute a Risk Management Committee.
- The **majority of members of Risk Management Committee** shall consist of **members of the board of directors**.
- The Chairperson of the Risk management committee shall be a member of the board of directors and senior executives of the listed entity may be members of the committee.
- **The risk management committee shall meet at least once in a year.**
- The board of directors shall define the **role and responsibility of the Risk Management Committee** and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit (**such function shall specifically cover cyber security**).
- The provisions of this regulation shall be **applicable to top 500 listed entities**, determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

OTHER COMMITTEES

1. **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**. A company may constitute this Committee to develop and recommend the board a set of corporate governance guidelines applicable to the company, implement policies and processes relating to **corporate governance, to review, periodically, the corporate governance guidelines of the company**.

2. **Regulatory, Compliance & Government Affairs Committee:**

- The primary objective of the **Compliance Committee is to review, oversee, and monitor**.
- The **Company's compliance with applicable legal and regulatory requirements**.
- The Company's policies, **programmes, and procedures to ensure** compliance with relevant laws, the **Company's Code of Conduct, and** other relevant standards.

3. **Science, Technology & Sustainability Committee:**

- **Monitor and review the overall strategy**, direction and effectiveness of the Company's research and development.
- Serve as a resource and provide input, as needed, regarding the **scientific and technological aspects of product safety matters**.
- Review the Company's policies, **programmes and practices on environment, health, safety and sustainability**.

4. **Fraud Monitoring Committee:** Although the fraud related aspects may be taken care of by the Audit Committee, but in some companies which are in field of financial services, there may be need of the **separate fraud monitoring committee**, which may take care of the checks and balances and **preventive measures in order to discourage the employees** in their modus operandi.

5. **Performance Appraisal Review Committee:** This committee periodically (say annually) reviews the performance to **Top Executives/ Key Managerial Person of the company** as well as the Directors of the company. It is just like the performance review of the each and every employee, which happens in most of the organizations.

SOME EXAMINATION QUESTIONS

1. What is the need and what are the advantages of Committee Management?
2. What are the mandatory committees of board?
3. A key element in Corporate Governance process of any organization is its Audit Committee.
4. Discuss in detail about nomination and remuneration committee.
5. Explain the importance of constitution of Risk Management Committee?
6. ICSI Recommendations to strengthen Corporate Governance framework.
7. Short notes:
 - Fraud Monitoring Committee.
 - Performance Appraisal Review Committee.

CHAPTER 6

Corporate Policies and Disclosures

Importance of corporate policies

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

- Policies are necessary to perform **the business activities in a smooth way.**
- Corporate policies offer **clear cut courses for achievement of organizational goals.**
- Corporate Policies present you with instructions and a platform for **making decisions.**
- Policies **promote delegation of the power of making decisions.**
- Properly formulated corporate policies give a direction in which all management pursuits are targeted.
- Policies provide steadiness to the action of the members of the organization.
- It helps in dealing with the **issues for optimal utilization of limited resources.**
- Sound policies aid in developing good public image of an organization.
- **They act as tool for co-ordination and control.**

Policies under the Companies Act 2013

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| | | | |
| CSR Policy | Risk Management Policy | Vigil Machanisam Policy | Nominations Remuneration Policy |
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1. Corporate Social Responsibility Policy:

Section 135(4) of the Companies Act 2013, the Board of every company required to **constitue CSR Committee shall after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy** for the company and disclose contents of such Policy in its report and also **place it on the company's website**, and ensure that the activities as are included in Corporate Social

Responsibility Policy of the company are undertaken by the company. **The CSR Policy of the company shall, inter-alia, include the following namely:-**

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

Activities which may be included by companies in their Corporate Social Responsibility Policies are activities relating to:(Schedule VII)

- Eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the **Swach Bharat Kosh set-up by the Central Government** for the promotion of sanitation and making available **safe drinking water.**
- promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects.
- **promoting gender equality**, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups.
- ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the **Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga.**
- **protection of national heritage, art and culture** including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional art and handicrafts;
- measures for the benefit of armed forces veterans, war widows and their dependents;
- **training to promote rural sports, nationally recognised sports, paralympic sports and olympic sports.**
- **contribution to the prime minister's national relief fund** or any other fund set up by the central govt. for socio economic development and

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| | <p>relief and welfare of the schedule caste, tribes, other backward classes, minorities and women;</p> <ul style="list-style-type: none"> ➤ contributions or funds provided to technology incubators located within academic institutions which are approved by the central govt. ➤ rural development projects. ➤ slum area development. |
| | <p>2. Risk Management Policy</p> <p>Section 134 (3) (n) of the Companies Act 2013, provides that a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company should be included in the report by its Board of Directors.</p> |
| | <p>3. Vigil Mechanism Policy</p> <p>Section 177 (10) of the Companies Act 2013 provides that the vigil mechanism under sub-section (9) shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases and the details of establishment of such mechanism shall be disclosed by the company on its website, if any, and in the Board’s report.</p> |
| | <p>4. Nomination and Remuneration policy</p> <p>Section 178 (3) and (4) of the Companies Act 2013 provides that the Nomination and Remuneration Committee shall formulate the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees.</p> <ul style="list-style-type: none"> ➤ 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; ➤ relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and ➤ 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: |

Policies under the SEBI (LODR), Regulations, 2015

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

The provisions of the Companies Act, 1956 and Companies Act, 2013, and the rules, regulations, circulars or guidelines made thereunder.
4. **Policy for Determining ‘Material’ Subsidiary:** “Material subsidiary” shall mean a subsidiary, **whose income or net worth exceeds 20% of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.** The listed entity shall formulate a policy for determining ‘material’ subsidiary. [Regulation 16(2)(c)]
5. **Policy on Materiality of Related Party Transactions:** A transaction with a related party shall be considered material if **the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds ten percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.** The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions. **[Regulation 23(1)]**
6. **Policy for determination of materiality of events:** The listed entity shall frame a policy for determination of materiality, duly approved by its board of directors, **which shall be disclosed on its website.** The

policy shall be based on the following criteria for determination of materiality of events/ information:

- The **omission of an event or information**, which is likely to result in **discontinuity or alteration** of event or information already available publicly; or
- The omission of an event or information is likely to result in **significant market reaction if the** said omission came to light at a later date;
- In case where the criteria specified in sub-clauses (a) and (b) are not applicable, an event/ information may be treated as **being material if in the opinion of the board of directors** of listed entity, the event / information is considered material.

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

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

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

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

- The **top five hundred listed entities** based on market capitalization (calculated as on March 31 of every financial year) shall formulate a dividend distribution policy which shall be disclosed in **their annual reports and on their websites.**
- The **dividend distribution policy** shall include the following parameters:
 - the circumstances under which the shareholders of the listed entities may or may not expect dividend;
 - the **financial parameters** that shall be considered while declaring dividend;
 - **internal and external factors that shall be considered for declaration of dividend;**
 - **policy as to how the retained earnings shall be utilized;** and

| | <p style="text-align: center;">➤ parameters that shall be adopted with regard to various classes of shares:</p> <p>If the listed entity proposes to declare dividend on the basis of parameters in addition to clauses (a) to (e) or proposes to change such additional parameters or the dividend distribution policy contained in any of the parameters, it shall disclose such changes along with the rationale for the same in its annual report and on its website.</p> <p>The listed entities other than top five hundred listed entities based on market capitalization may disclose their dividend distribution policies on a voluntary basis in their annual reports and on their websites.</p> | | | | |
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| <p>POLICIES UNDER OTHER LAWS AND VOLUNTARY POLICIES</p> | <ol style="list-style-type: none"> 1. Insider Trading Policy; 2. Policy for prevention of sexual harassment at workplace; 3. Voluntary Policies: In addition to above, the companies may also formulate following policies: <ul style="list-style-type: none"> ➤ Code of business conduct & Ethics ➤ Ethics policy ➤ Information security policy ➤ Health and safety policy ➤ Gender diversity policy ➤ Environmental policy ➤ Policy on investor relations ➤ Quality policy ➤ Social accountability policy ➤ Communication policy ➤ Investment and cash policy | | | | |
| <p>SECTION 135(3)(A)</p> | <p>The Central Government may prescribe an abridged Board's report, for the purpose of compliance with this section by</p> <div style="border: 1px solid black; background-color: #cccccc; padding: 5px; text-align: center; margin: 10px 0;"> <p>Section 134 FINANCIAL STATEMENT, BOARD'S REPORT, ETC.</p> </div> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 30%; text-align: center;">Core areas</th> <th style="text-align: center;">Provisions</th> </tr> </thead> <tbody> <tr> <td style="vertical-align: top;"> <p>Signing Of The Financial Statements</p> </td> <td> <p>1)The financial statement, including consolidated financial statement, if any, shall be :-</p> <ul style="list-style-type: none"> • shall be approved by the Board of Directors before they are signed on behalf of the Board by • the chairperson of the company where he is authorised by the Board or • by two directors out of which one shall be managing director, if any, and the Chief </td> </tr> </tbody> </table> | Core areas | Provisions | <p>Signing Of The Financial Statements</p> | <p>1)The financial statement, including consolidated financial statement, if any, shall be :-</p> <ul style="list-style-type: none"> • shall be approved by the Board of Directors before they are signed on behalf of the Board by • the chairperson of the company where he is authorised by the Board or • by two directors out of which one shall be managing director, if any, and the Chief |
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| | | <p>Executive Officer, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon.</p> |
| | <p>Auditor`S Report Attached To Financial Statements</p> | <p>2) The auditors’ report shall be attached to every financial statement.</p> |
| | <p>Boards Report</p> | <p>3) & 4) There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include—</p> <ul style="list-style-type: none"> a) ANNUAL RETURN:- will be the web address if ,any,where annual return referred to in section 92(3) has been placed. b) Number of BM:- number of meetings of the Board c) DRS:- Directors’ Responsibility Statement; (ca) details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government CA)FRAUD REPORTING:- details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government. d) INDEPENDENCE DECLARATION :- a statement on declaration given by independent directors under sub-section (6) of section 149; e) NOMINATION & REMUNERATION COMMITTEE:- 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 provided under sub-section (3) of section 178; (Not Applicable to Government Companies) f) EXPLANATIONS ON AUDITORS QUALIFICATION:- explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made— |

| | | <ul style="list-style-type: none"> • by the auditor in his report; and • by the company secretary in practice in his secretarial audit report; <p>g) INTER CORPORATE LOANS AND INVESTMENTS :- particulars of loans, guarantees or investments under section 186;</p> <p>h) section 188 in the prescribed form AOC 2;</p> | | | | |
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| | | <p>of the performance of Board its committees and of individual directors has been made; (Not Applicable to Government Companies)</p> |
| | <p>such other matters as prescribed below.</p> | <p><i>In addition to the information and details specified in sub-rule (4), the report of the Board shall also contain –</i></p> <ol style="list-style-type: none"> 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,- <ol style="list-style-type: none"> <i>a) accepted during the year;</i> <i>b) remained unpaid or unclaimed as at the end of the year;</i> <i>c) whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved-</i> <ul style="list-style-type: none"> • <i>at the beginning of the year;</i> • <i>maximum during the year;</i> • <i>at the end of the year;</i> VI. the details of deposits which are not in compliance with the requirements of 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 <p><i>Provided that where disclosures referred to in this sub-section have been included in the financial statements, such disclosures shall be referred to instead of being repeated in the Board’s report;</i></p> <p><i>Provided further that where the policy referred to in clause (e) or clause (o) is made available on company’s website, if any, it shall be sufficient compliance of the requirements under such clauses if the salient features of the policy and any change therein are specified in brief in the Board’s report and the web-address is indicated</i></p> |

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| | | <i>therein at which the complete policy is available.</i> | |
| | | a One Person Company or small company. | |
| SECTION 135(4) | | The report of the Board of Directors to be attached to the financial statement under this section shall, in case of a One Person Company, mean a report containing explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report. | |
| SECTION 134(5) Directors' Responsibility Statement | | | |
| <p>In the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;</p> <p>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;</p> <p>The directors had taken proper and sufficient care for the:-</p> <ul style="list-style-type: none"> • 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; <p>The directors had prepared the annual accounts on a going concern basis; and</p> <p>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</p> <p>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;</p> <p>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.</p> | | | |
| SECTION 134(6) SIGNING OF THE BOARD REPORT | | | |

The **Board's report and any annexures** thereto under sub-section (3) shall be **signed by :-**

- a) **its chairperson of the company** if he is authorised by the Board and
- b) where he is not so authorised, shall be **signed by at least two directors**, one of whom shall be a managing director, or
- c) by the **director where there is one director (in case of OPC)**.

Note - Each & every page of annexure to be signed.

A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of—

1. any notes annexed to or forming part of such financial statement;
2. the auditor's report; and
3. the Board's report referred to in sub-section (3).

Section 134(8) PENALTY FOR NON COMPLIANCE

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 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 or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.**

Details of certain employees in Board Report

- Name of Top 10 Employees

- Every employee who gets more than the prescribed amount

OR

Employee whose Remuneration > MD/WD/MGER and Shareholding + Spouse > 2% of Equity of the Co + Dependent Child

Disclosures under other Sections of Companies Act, 2013

1. Disclosures under other Sections of Companies Act, 2013

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

- the **level and composition of remuneration** is reasonable

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| | <p>and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;</p> <ul style="list-style-type: none"> ➤ relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and ➤ 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. <p>As per section 149(10) an independent director shall be eligible for reappointment on passing of a special resolution and the Board’s Report shall disclose such appointment.</p> <p>Under section 177(8), Board’s Report shall disclose the composition of audit committee and shall also disclose the recommendation of the audit committee which is not accepted by the board along with reasons thereof.</p> <p>Proviso to section 177(10) prescribes the inclusion of the details of establishment of vigil mechanism under section 177(9) in the Board’s Report.</p> <p>As per section 204(1) every listed company and other prescribed companies in Rule 9 Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014 shall annex the secretarial audit report given by a Company Secretary in practice with Board’s Report. Board in its report shall explain any qualification or observation or other remarks made by the Company Secretary in Practice.</p> <p>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.</p> <p>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 twentyfive 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.</p> |
| <p>Under SEBI (Substantial Acquisition of Shares and Takeovers)</p> | <p>Under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011:</p> <ul style="list-style-type: none"> ➤ Disclosure of acquisition and disposal (Regulation 29). |

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| Regulations, 2011 | <ul style="list-style-type: none"> ➤ Continual disclosures (Regulation 30). ➤ Disclosure of encumbered shares (Regulation 31). |
| Under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 | <p>Under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015:</p> <ul style="list-style-type: none"> ➤ Prior Intimations (Regulation 29) ➤ Disclosure of Events or Information [Regulation (30)] ➤ Disclosures of Financial Results [Regulation (33)] ➤ Annual Report Disclosures [Regulation (34)] ➤ Website Disclosures [Regulation (46)] ➤ |
| <p>UNDER SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015 <u>REFER SEBI (PIT) REGULATION NOTES.</u></p> | <p>UNDER SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015:</p> <p>Disclosures of Trading By Insiders</p> <p>Regulation 6(2) : The disclosures to be made by any person shall include those relating to trading by such person’s immediate relatives, and by any other person for whom such person takes trading decisions. It is intended that disclosure of trades would need to be of not only those executed by the person concerned but also by the immediate relatives and of other persons for whom the person concerned takes trading decisions. These regulations are primarily aimed at preventing abuse by trading when in possession of unpublished price sensitive information and therefore, what matters is whether the person who takes trading decisions is in possession of such information rather than whether the person who has title to the trades is in such possession.</p> <p>The disclosures of trading in securities shall also include trading in derivatives of securities and the traded value of the derivatives shall be taken into account for purposes of this Chapter, provided that trading in derivatives of securities is permitted by any law for the time being in force.</p> <p>The disclosures made shall be maintained by the company, for a minimum period of five years, in such form as may be specified.</p> <p>Disclosures by Certain Persons</p> <ul style="list-style-type: none"> ➤ Initial Disclosure (Regulation 7 (1)) ➤ Continual Disclosures: Regulation 7(2) <p>Disclosures by other connected persons</p> <p>Any company whose securities are listed on a stock exchange may, at its discretion require any other connected person or class of connected persons to make disclosures of holdings and trading in securities of the company in</p> |

such form and at such frequency as may be determined by the company in order to monitor compliance with these regulations.

Code of Fair Disclosure (Regulation 8) (1)

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

SOME EXAMINATION QUESTIONS

1. What are the mandatory policies to be formulated under Companies Act 2013? Describe in brief.
2. What are the disclosure pertaining to financial requirements under SEBI LODR Regulations, 2015?
3. Draft a sample corporate governance report of a listed company.
4. Write short note on CSR Policy.
5. Write in brief about various policies under SEBI LODR Regulations, 2015.
6. What are the contents of Management Discussion and Analysis report?
7. What the disclosures to be made in Corporate Governance Report?
8. What are the Financial Information which are required to be disclosed on the website of the company as per regulation 46 of SEBI [LODR] Regulations ,2015.

CHAPTER 7
ACCOUNTING AND AUDIT RELATED ISSUES, RPTS AND VIGIL MECHANISM

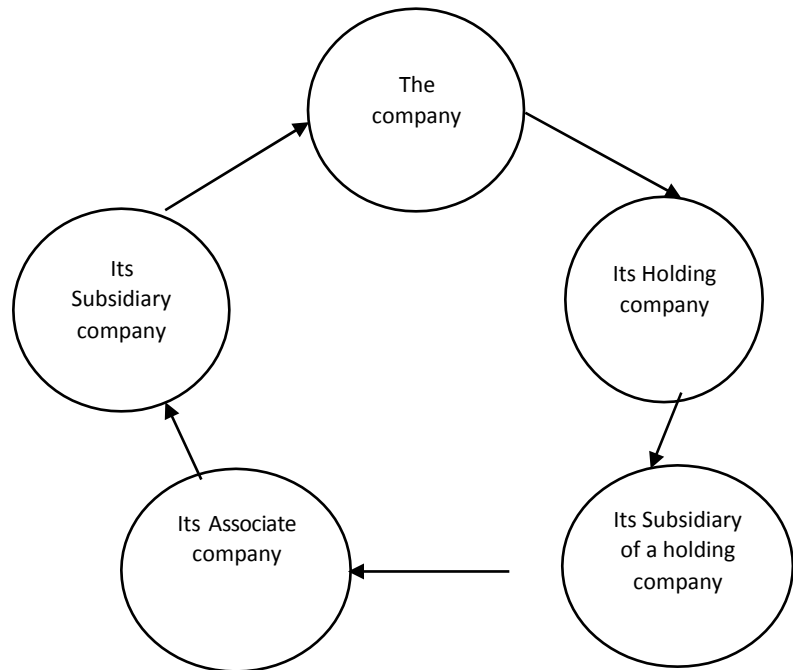
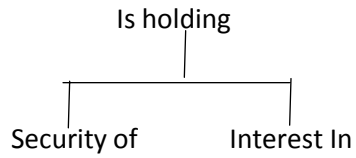
| Core Areas | Provisions |
|----------------|---|
| Sec 141(1) (2) | Qualification of Auditor |
| | <p>(1) A person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant: Provided that a firm whereof majority of partners practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.</p> <p>(2) Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.</p> |
| Sec 141(3) | <p>The following persons shall not be eligible for appointment as an auditor of a company, namely:—</p> <p>(a) <i>a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;</i></p> <p>(b) <i>an officer or employee of the company;</i></p> <p>(c) <i>a person who is a partner, or who is in the employment, of an officer or employee of the company;</i></p> <p>(d) <i>a person who, or his relative or partner—</i></p> <p style="padding-left: 40px;">(1) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company: <i>Provided that the relative may hold security or interest in the company of face value not exceeding one lakh rupees;</i> <i>If the relative is holding securities more than 1 lakh rupees he has to disposed it of within 60 days.</i></p> <p style="padding-left: 40px;">(2) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of five lakh rupees; or</p> <p style="padding-left: 40px;">(3) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of one lakh rupees;</p> <p>(e) <i>a person or a firm who, whether directly or indirectly, has “business relationship” with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;</i></p> |

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| | <p>The term “business relationship” means any commercial transaction but excludes as follows:</p> <p>(i) <i>commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;</i></p> <p>(ii) <i>commercial transactions which are in the ordinary course of business of the company at arms length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.</i></p> <p>(f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;</p> <p>(g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;</p> <p>one person companies, dormant companies, small companies and Private Companies having paid up share capital of less than ` 100/- Crore, are not to be counted in the maximum limit of audit which is twenty for Auditors</p> <p>(h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;</p> <p>(i) a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.</p> |
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Notes:

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| <p>Substantial Interest (Progressive Basis)</p> | <p>A CA shall be guilty of professional misconduct if he expresses opinion on financial statements of an enterprise if his relative holds substantial interest (≥ 20% voting sh/profit)</p> <p>Q) An auditor recovers fees on progressive basis 7 lacs. Is he disqualified</p> <p>Ans: No</p> |
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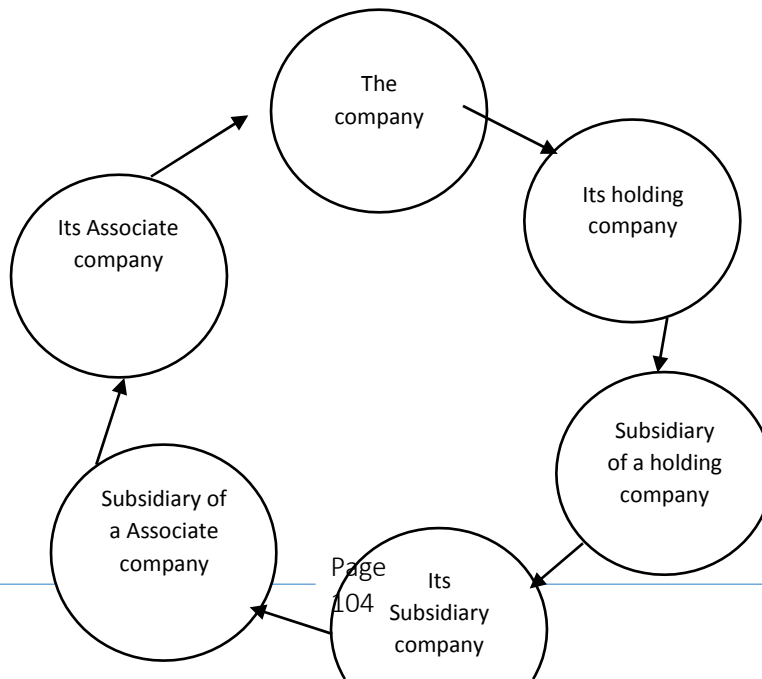
d) Is a PERSON, Who is his RELATIVE or a partner



5 KA CHAKRAVYUH SPECIAL CASE

e) Is a PERSON or a FIRM who :

DIRECTLY or INDIRECTLY HAS BUSINESS RELATIONSHIP*

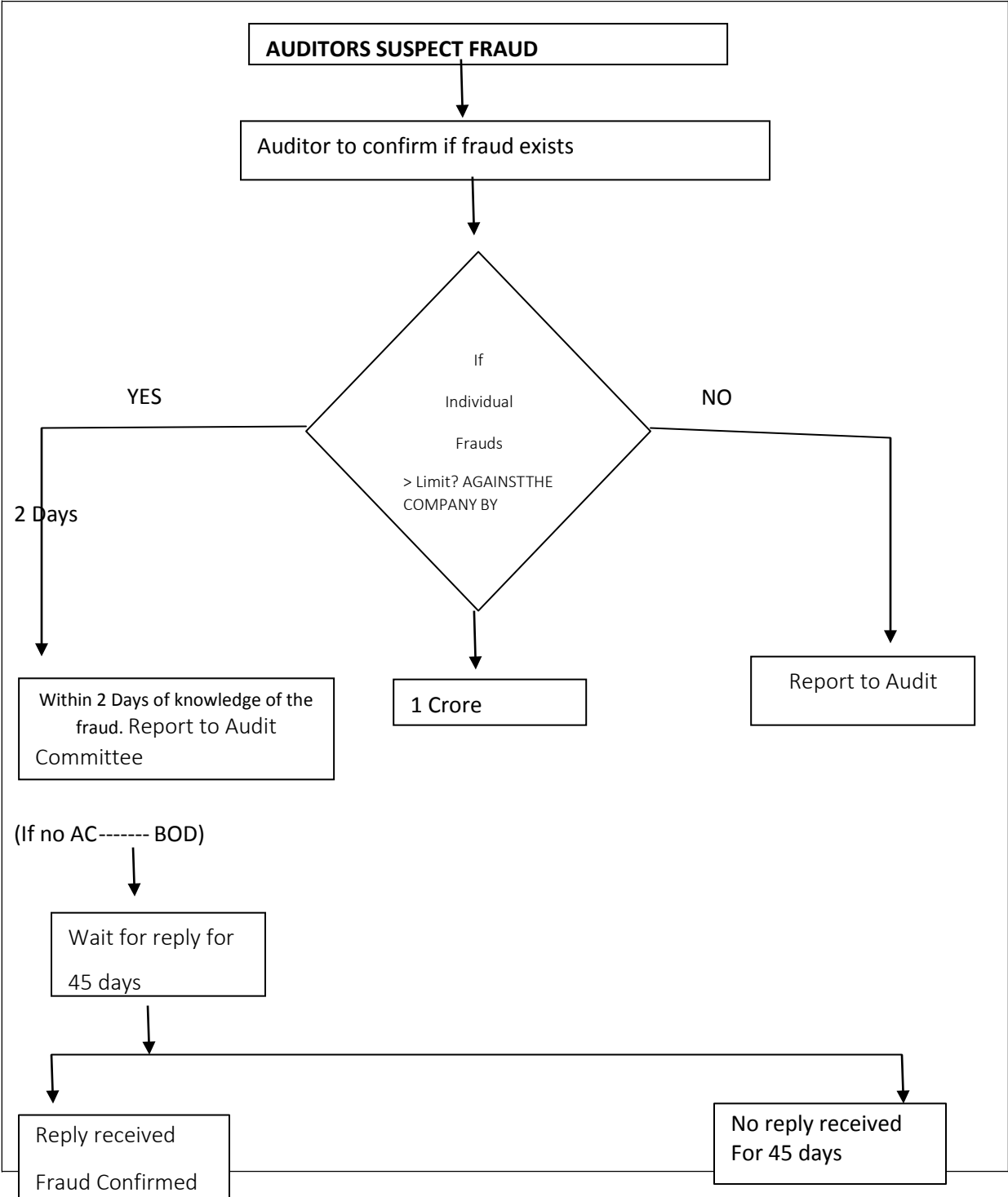


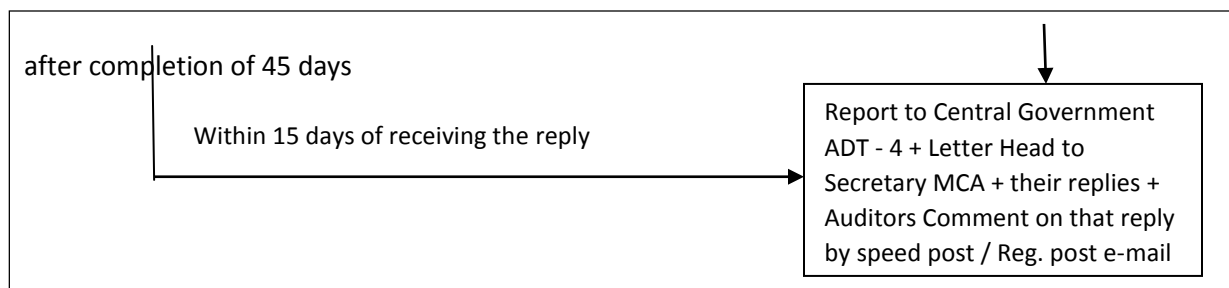
6 KA CHAKRAVYUH SPECIAL CASE

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|-------------|----------------------------------|
| Sec 143(12) | Reporting of Fraud By An Auditor |
|-------------|----------------------------------|

| Core Areas | Provisions | | |
|-----------------------------|--|-----------------------------|---|
| | <p>this purpose the Companies (Audit and Auditors) Amendment Rules, 2015 (“Audit Amendment Rules”), were notified on December 15, 2015.</p> <p>Under the earlier provisions, any fraud being committed against the company by its officers or employees was required to be reported to the Central Government. Now a threshold of ` 1 crore has been inserted.</p> <p>If the auditor does discover a fraud of ` 1 crore or above, then the auditor must report the fraud to the board of directors or the audit committee of the company (as the case may be) not later than 2 days of discovery of the fraud. Then the board of directors or audit committee is required to give its reply or observations to the auditor within 45 days, which is to be forwarded to the Central Government, failing which, the auditor shall forward his own report to the central government with a note mentioning that no reply or observations were received from the board of directors or the audit committee of the company within the prescribed 45 days.</p> <p>For a fraud below ` 1 crore, the auditor is required to report the fraud to the board of directors or the audit committee not later than 2 days of its discovery specifying the name of the fraud committed with a description of the same, the approximate involved and the parties involved in the fraud. Then, in the report of the board of directors for that financial year, the above mentioned details shall be provided along with the remedial action which was taken resultant to the fraud which was committed.</p> <p>Reporting of Fraud by an Auditor (Sec. 143(12) to (15) of the Companies Act, 2013</p> | | |
| | <table border="1"> <tr> <td style="width: 50%;">When is reporting required?</td> <td> <ul style="list-style-type: none"> • if ifAn auditor has reason to believe • that an offence involving material fraud has been committed or is being committed • Against the company by officers or </td> </tr> </table> | When is reporting required? | <ul style="list-style-type: none"> • if ifAn auditor has reason to believe • that an offence involving material fraud has been committed or is being committed • Against the company by officers or |
| When is reporting required? | <ul style="list-style-type: none"> • if ifAn auditor has reason to believe • that an offence involving material fraud has been committed or is being committed • Against the company by officers or | | |

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| | | <p>employees of the company</p> <ul style="list-style-type: none"> • Auditor is required to report such material Fraud |
| | Report to whom? | The auditor shall report the matter to CG |
| | No liability of auditor | <ul style="list-style-type: none"> • an auditor shall not be deemed to be guilty for breach of any of his duties • by reason of his reporting any matter to CG |
| | Provisions applicable to other auditors | <p>The provision about reporting of fraud shall mutatis mutandis apply to –</p> <p>a) the cost accountant in practice conducting cost audit u/s 148, or</p> <p>b) the company secretary in practice conducting secretarial audit u/s 204</p> |
| | Punishment for non-compliance | <p>minimum fine ` 1,00,000</p> <p>maximum fine ` 25,00,000</p> |
| | Time and manner of reporting of fraud by auditor (Rule 13) | <p>The report shall be in the form of a statement as specified in Form ADT-4</p> <p>These provisions shall also apply,, mutatis mutandis, to –</p> <ul style="list-style-type: none"> • a cost auditor during the performance of his duties u/s 148; and • a secretarial auditor during the performance of his duties u/s 204 |
| No Liability Of auditor (Sec 143(13)) | No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12) if it is done in good faith. | |
| Provisions applicable to other auditors (Sec 143(14)) | <p><i>The provisions of this section shall mutatis mutandis apply to—</i></p> <p>(a) the <i>cost accountant</i> conducting cost audit under section 148; or</p> <p>(b) the <i>company secretary in practice</i> conducting secretarial audit under section 204.</p> | |
| Punishment for Non-compliance (Sec 143(15)) | If any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees. | |





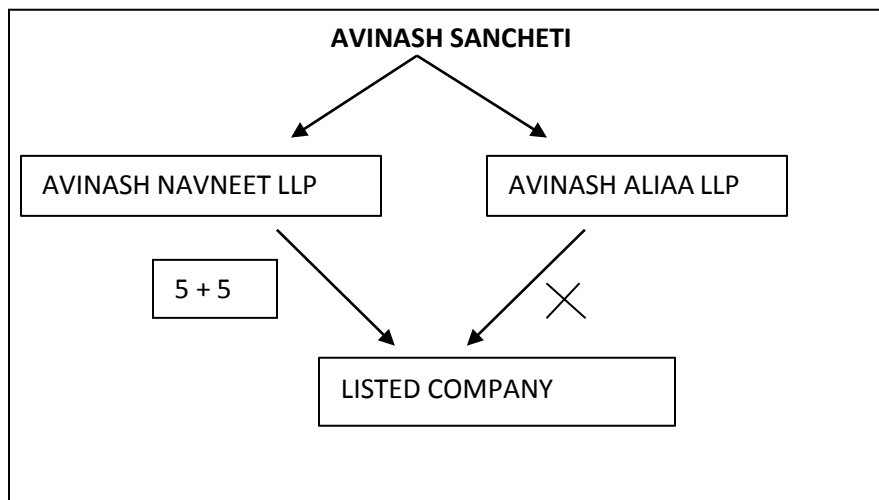
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| Sec 144 | Audit Not to render certain Service |
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| Core Areas | Provisions |
|--------------------------------------|--|
| Services to be approved | <i>An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be,</i> |
| Prohibited Services | <p><i>An auditor shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company, namely:—</i></p> <ul style="list-style-type: none"> (a) accounting and book keeping services; (b) internal audit; (c) design and implementation of any financial information system; (d) actuarial services; (e) investment advisory services; (f) investment banking services; (g) rendering of outsourced financial services; (h) management services; and (i) any other kind of services as may be prescribed: |
| Meaning of 'Directly and Indirectly' | <p>Explanation—For the purposes of this sub-section, the <i>term “directly or indirectly”</i> shall include rendering of services by the auditor,—</p> <p><i>(i) in case of auditor being an individual, either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual;</i></p> <p><i>(ii) in case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners.</i></p> |

MANDATORY ROTATION OF AUDITORS

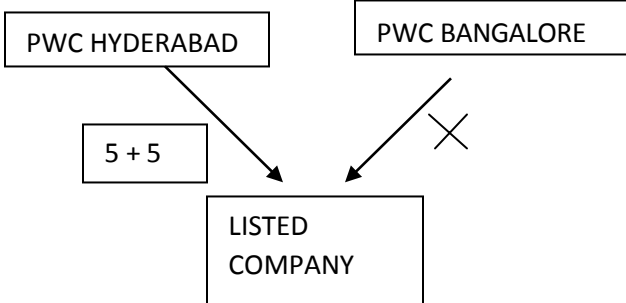
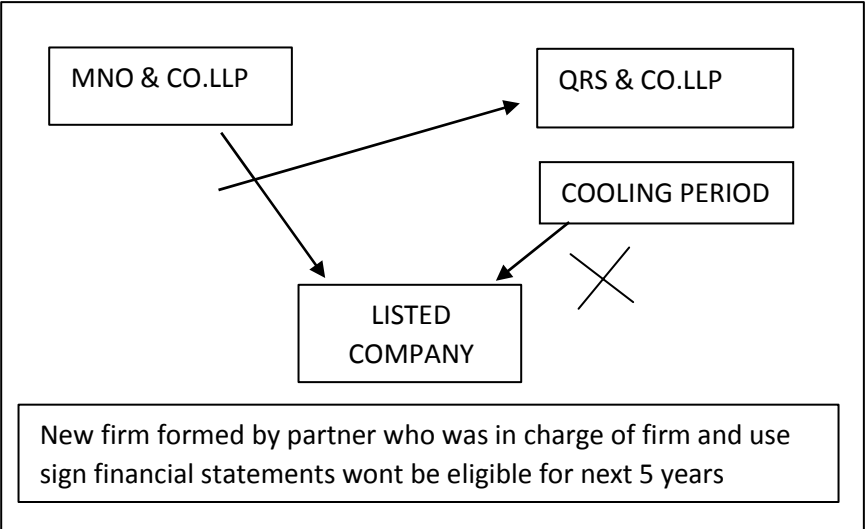
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| Sec 139(2) ,(4) | Rotation of Auditor |
| | A) For which company Rotation of Audit from Not compulsory B) For which company Rotation of Audit from compulsory |
| Sec 139(2) ,(4) | A. Not compulsory OPC Small Company B. 1. Listed Company. 2. Unlisted public company paid up share capital ≥ 10 Crores 3. PVT Ltd company paid up share capital ≥ 50 Crores 4. Company having public borrowings from financial institution , banks or public deposits ≥50 Crores |

CASE 1 :- COMMON PARTNER



CASE 2 :-SAME NETWORK/BRAND



| | |
|---------------------------|--|
| | <div style="text-align: center;">  </div> <p>RESIGN & JOIN</p> <div style="border: 1px solid black; padding: 10px; margin: 10px auto; width: 80%;">  <div style="border: 1px solid black; padding: 5px; margin-top: 5px; text-align: center;"> New firm formed by partner who was in charge of firm and use sign financial statements wont be eligible for next 5 years </div> </div> |
| <p>Explanation</p> | <p>a) As on the date of appointment no audit firm having a common partner or partners to the other firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as a auditor of the same company for a period of 5 years</p> <p>b) The incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms For the purposes of these rules the term “same network” includes the firms operating or functioning, hitherto, under the same brand name, trade mark, or common control</p> <p>c) If a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joints another firm of chartered accountants, such other firms shall</p> |

| | | |
|-------------------|--|-----------------------|
| | also be ineligible to be appointed for a period of 5 years | |
| | Auditor should serve cooling period as Follows | |
| | Type of Auditor | Cooling period |
| | Individual Auditor | 5 years |
| | Ca Firm | 5 years |
| Sec 139(3) | Rotation of Audit Partner, Audit Team, and Joint Audit | |
| | Subject to the provisions of this Act, members of a company may resolve to provide that— (a) in the audit firm appointed by it , the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or (b) the audit shall be conducted by more than one auditor. | |

AUDITING STANDARDS

- The Standards on Auditing have been accorded legal sanctity in the under the Companies Act 2013. Auditors are now mandatorily bound by to ensure compliance with Standards on Auditing.
- **As per Section 143(2)** of the Companies Act 2013, the auditor shall **make a report to the members of the company** on the accounts examined by him and on **every financial statements** which are required by or under this Act to be laid **before the company in general meeting** and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to **be included in the audit report under** the provisions of this Act or any rules made thereunder or under any order made undersub-section (11) and to the **best of his information and knowledge, the said accounts, financial statements** give a **true and fair view of the state of the company’s affairs as at the end of its financial year** and **profit or loss and cash flow for the year and such** other matters as may be prescribed.
- **As per Section 143(9)** of the Companies Act 2013, it is the duty of every auditor to **comply with the auditing standards.**
- **The Section 143(10)** confers power to the **Central Government** to prescribe the standards of auditing as **recommended by the Institute of Chartered Accountants of India** in consultation with the **National Financial Reporting Authority**:
 However, **until any auditing standards are notified**, any standard or standards of auditing specified **by the Institute of Chartered Accountants of India** shall be **deemed to be the auditing standards.**

SECTION 138 INTERNAL AUDIT

| Core areas | Provisions |
|-----------------------|--|
| Internal Audit | Internal Audit is a part of internal control which ensures that whether other parts of internal control are operating effectively. |

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| <p>Mandatory for certain companies only</p> | <p>1) Following companies as prescribed below 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.</p> <p>The following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely:-</p> <p>a) every listed company;</p> <p>b) every unlisted public company having:-</p> <ul style="list-style-type: none"> • paid up share capital of FIFTY CRORE RUPEES or more during the preceding financial year; or • turnover of TWO HUNDRED CRORE RUPEES or more during the preceding financial year; or • outstanding loans or borrowings from banks or public financial institutions exceeding ONE HUNDRED CRORE RUPEES or more at any point of time during the preceding financial year; or • outstanding deposits of TWENTY FIVE CRORE RUPEES or more at any point of time during the preceding financial year; and <p>c) every private company having-</p> <ul style="list-style-type: none"> • turnover of TWO HUNDRED CRORE RUPEES or more during the preceding financial year; or • outstanding loans or borrowings from banks or public financial institutions exceeding ONE HUNDRED CRORE RUPEES or more at any point of time during the preceding financial year <p><i>Provided that an existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within six months of commencement of such section.</i></p> <p><i>Explanation. - For the purposes of this rule -</i></p> <ul style="list-style-type: none"> ➤ <i>the internal auditor may or may not be an employee of the company;</i> ➤ <i>the term “Chartered Accountant” shall mean a Chartered Accountant whether engaged in practice or not</i> |
| <p>Who determines the scope?</p> | <p>2)The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.</p> |

| Internal audit compulsory for | Paid up capital | Turnover | Outstanding loans and borrowings | Outstanding deposits |
|-------------------------------|-----------------|----------|----------------------------------|----------------------|
| Every Listed Company | | | | |

| | | | | |
|------------------------|---------------|----------------|----------------|---------------|
| Public Company | 50 Cr or more | 200 Cr or more | 100 Cr or more | 25 Cr or more |
| Private Company | No limit | 200 Cr or more | 100 Cr or more | No limit |

| Core areas | Provisions |
|-------------------|---|
| Other points | 3) 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. |

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| 1. | Are the following companies required to conduct internal audit as per Sec 138 i. Unlisted Public Company with paid up capital 48 crore and turnover 250 crore ii. Private company with paid up capital 55 crore iii. Private Company whose turnover is 250 crore |
| 2. | What qualification is prescribed for internal auditor? |
| 3. | Who determine the scope of Internal auditor? |
| 4. | Can an employee of the company be appointed as internal auditor? |
| 5. | Can a chartered accountant, not in practice be appointed as internal auditor? |

SECRETARIAL AUDIT

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

- Every listed company;
- Every public company having a **paid-up share capital of fifty crore rupees or more;** or
- Every public company having a **turnover of two hundred fifty crore rupees or more.**
- **Every company having outstanding loans or borrowings from banks or public financial institutions of one hundred crore rupees or more. (new provision)* (03-01-2020)**

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

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| SEC 132 | Constitution of National Financial Reporting Authority(NFRA) |
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| Core Areas | Provisions |
|-----------------------|---|
| Section 132(1) | The Central Government may, by notification, constitute a National |

| | |
|--|--|
| <p>CG Constitutes NFRA</p> | <p>Financial Reporting Authority to provide for matters relating to accounting and auditing standards under this Act. NFRA shall perform such its functions through such divisions as may be prescribed</p> <p>(1A) The National Financial Reporting Authority shall perform its functions through such divisions as may be prescribed</p> |
| <p>Section 132(2) Role of NFRA</p> | <p>Notwithstanding anything contained in any other law for the time being in force, the National Financial Reporting Authority shall--</p> <p>(a) make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be;</p> <p>(b) monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed;</p> <p>(c) oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed; and</p> <p>(d) perform such other functions relating to clauses (a), (b) and (c) as may be prescribed.</p> |
| <p>Section 132(3) Constitution of NFRA and its Composition</p> | <p>The NFRA shall Consist of:-</p> <ol style="list-style-type: none"> (1) chairperson, who shall be a person of eminence and having expertise in accountancy, auditing, finance or law to be appointed by the Central Government and (2) SUCH OTHER MEMBERS NOT EXCEEDING FIFTEEN consisting of part-time and full-time members as may be prescribed: <p>Provided that the terms and conditions and the manner of appointment of the chairperson and members shall be such as may be prescribed:</p> <p>Provided further that the chairperson and members shall make a declaration to the Central Government in the prescribed form regarding no conflict of interest or lack of independence in respect of his or their appointment:</p> <p>Provided also that the chairperson and members, who are in full-time employment with National Financial Reporting Authority shall not be associated with any audit firm (including related consultancy firms) during the course of their appointment and two years after ceasing to hold such appointment.</p> <p>3A) Each division of the National Financial Reporting Authority shall be presided over by the chairperson or a full time Members authorised by the Chairperson.</p> |

| | |
|--|---|
| | <p>3B) There shall be an executive body of the National Financial Reporting Authority consisting of the Chairperson and full-time members of such authority for effective discharge of its functions under sub-section(2)[other than clause(a) and sub-section (4).]</p> |
| <p>Section 132(4) Powers of NFRA</p> | <p>Notwithstanding anything contained in any other law for the time being in force, the National Financial Reporting Authority shall -</p> <p>(a) have the power to investigate, either suo motu or on a reference made to it by the Central Government, for such class of bodies corporate or persons, in such manner as may be prescribed into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949 (38 of 1949):</p> <p>Provided that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the National Financial Reporting Authority has initiated an investigation under this section;</p> <p>(b) have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908), while trying a suit, in respect of the following matters, namely:--</p> <p>(i) discovery and production of books of account and other documents, at such place and at such time as may be specified by the National Financial Reporting Authority;</p> <p>(ii) summoning and enforcing the attendance of persons and examining them on oath;</p> <p>(iii) inspection of any books, registers and other documents of any person referred to in clause (b) at any place;</p> <p>(iv) issuing commissions for examination of witnesses or documents;</p> <p>(c) where professional or other misconduct is proved, have the power to make order for--</p> <p>(A) imposing penalty of--</p> <p>(I) not less than one lakh rupees, but which may extend to five times of the fees received, in case of individuals; and</p> <p>(II) not less than Five lakh rupees, but which may extend to ten times of the fees received, in case of firms;</p> <p>(B) debarring the member or the firm from engaging himself or itself from being appointed as an Auditor or internal auditor of any company or body corporate Or from performing any valuation service u/s 247 for a minimum period of six months or for such higher period not exceeding ten years as may</p> |

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| | <p>be decided by the National Financial Reporting Authority.</p> <p><i>Explanation.--For the purposes of his sub-section, the expression “professional or other misconduct” shall have the same meaning assigned to it under section 22 of the Chartered Accountants Act, 1949 (38 of 1949).</i></p> |
| <p>Section 132(5) Appeal to NCLAT</p> | <p>Any person aggrieved by any order of the National Financial Reporting Authority issued under clause (c) of sub-section (4), may prefer an appeal before the Appellate Authority constituted under sub-section (6) in such manner as may be prescribed.</p> |
| <p>Section 132(6,7,8,9)</p> | <p>Omitted-</p> |
| <p>Section 132(10) Meeting</p> | <p>The National Financial Reporting Authority shall meet at such times and places and shall observe such rules of procedure in regard to the transaction of business at its meetings in such manner as may be prescribed.</p> |
| <p>Section 132(11) Secretary</p> | <p>The Central Government may appoint a secretary and such other employees as it may consider necessary for the efficient performance of functions by the National Financial Reporting Authority under this Act and the terms and conditions of service of the secretary and employees shall be such as may be prescribed.</p> |
| <p>Section 132(12) Officers</p> | <p>The head office of the National Financial Reporting Authority shall be at New Delhi and the National Financial Reporting Authority may, meet at such other places in India as it deems fit.</p> |
| <p>Section 132(13) Books- C & AG</p> | <p>The National Financial Reporting Authority shall cause to be maintained such books of account and other books in relation to its accounts in such form and in such manner as the Central Government may, in consultation with the Comptroller and Auditor-General of India prescribe.</p> |
| <p>Section 132(14) Audit- C & AG</p> | <p>The accounts of the National Financial Reporting Authority shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and such accounts as certified by the Comptroller and Auditor-General of India together with the audit report thereon shall be forwarded annually to the Central Government by the National Financial Reporting Authority.</p> |
| <p>Section 132(15) Parliament</p> | <p>The National Financial Reporting Authority shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report and the audit report given by the Comptroller and Auditor-General of India to be laid before each House of Parliament.</p> |

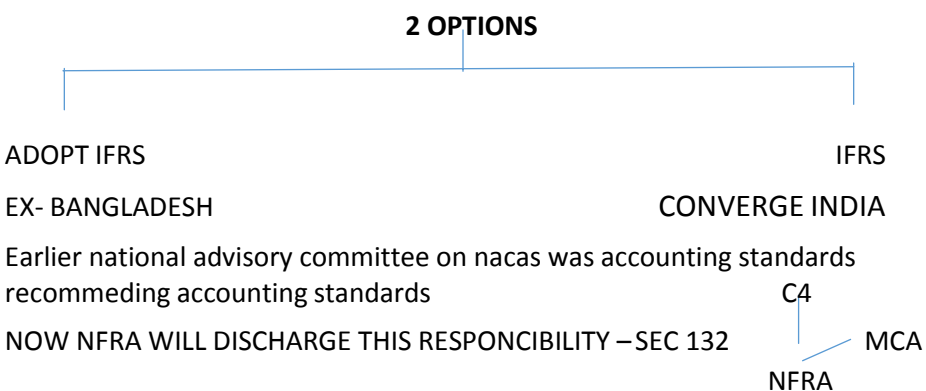
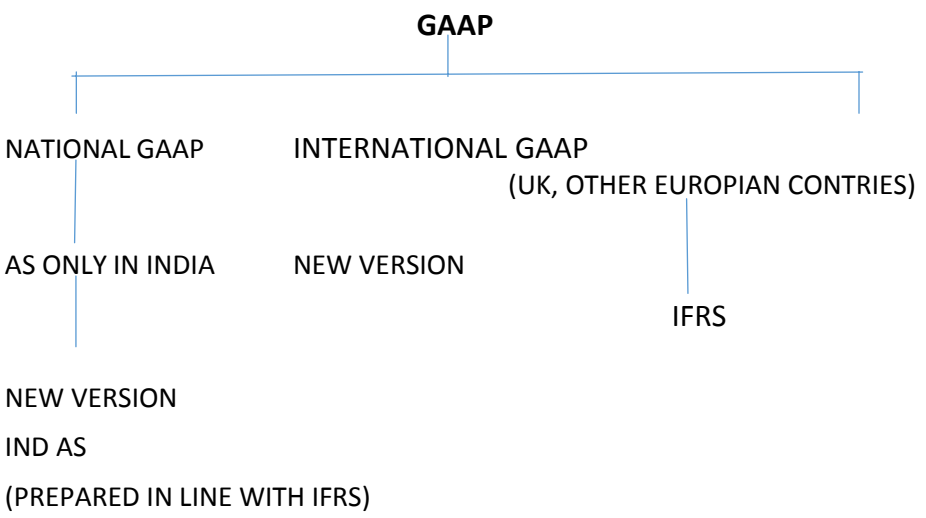
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| SEC 133 | Central Government to Prescribed Accounting Standards |
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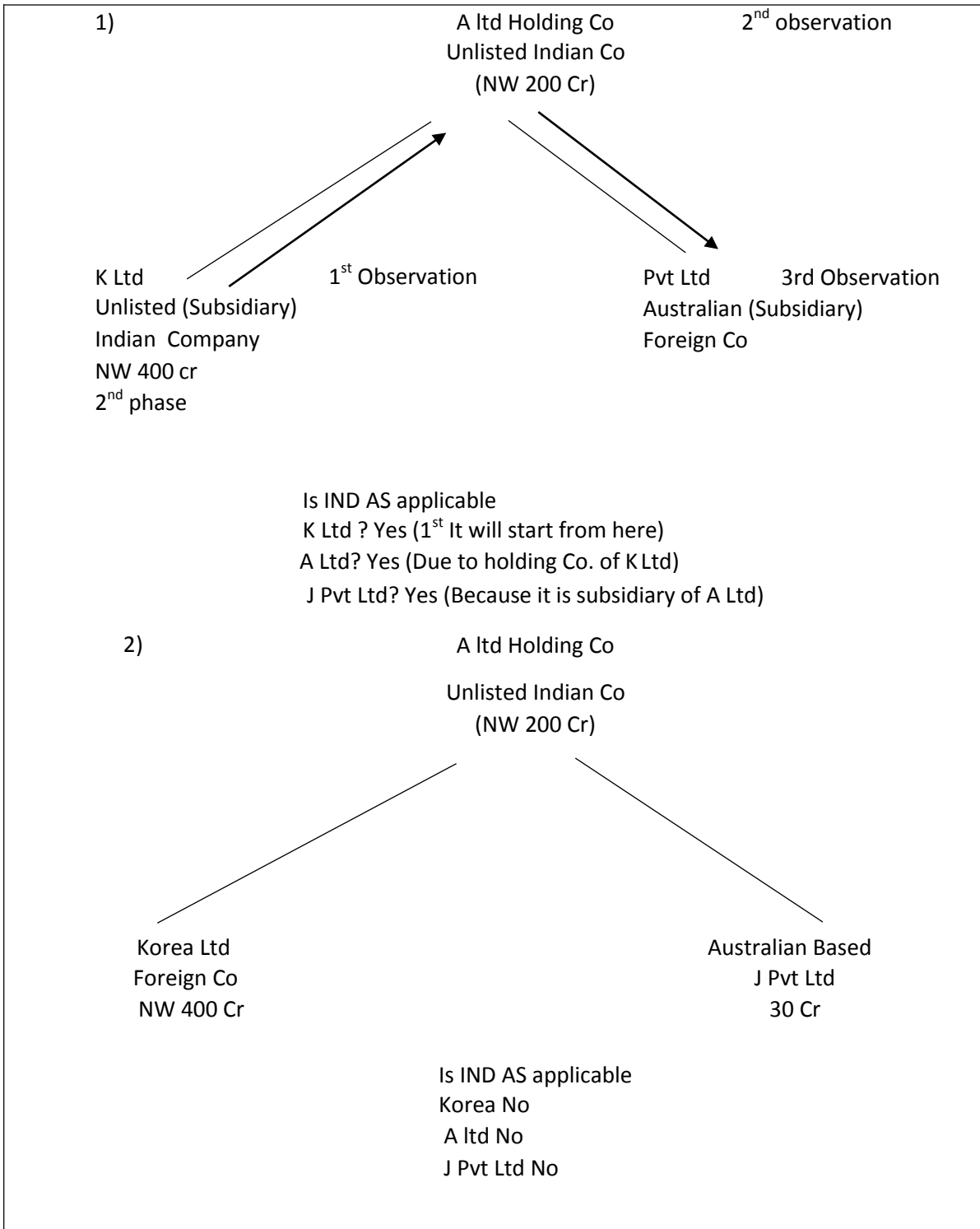
| Core Areas | Provisions | | | | | | | | | | | | | | | | |
|---------------------|---|--|---|----------|--------------------|------------------|--|--|---|---------------------|--|--|-----------------------|---------|------------------------|--|--|
| | <p>The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949 (38 of 1949), in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.</p> <p>The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949 (38 of 1949), in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.</p> <p>The MCA through notification dated 16 February 2015 has issued the Companies (Indian Accounting Standards) Rules, 2015 (Rules) which lay down a road map for companies. The Rules will come into force from the date of its publication in the Official Gazette. The Ind AS shall be applicable to companies as explained in the table below:</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th></th> <th style="text-align: center;">Phase I</th> <th style="text-align: center;">Phase II</th> <th style="text-align: center;">Voluntary Adoption</th> </tr> </thead> <tbody> <tr> <td>Year of adoption</td> <td style="text-align: center;">2016-17</td> <td style="text-align: center;">2017-18</td> <td style="text-align: center;">2015-16 or thereafter</td> </tr> <tr> <td>Comparison Year</td> <td style="text-align: center;">2015-16</td> <td style="text-align: center;">2016-17</td> <td style="text-align: center;">2014-15 or thereafter</td> </tr> </tbody> </table> | | Phase I | Phase II | Voluntary Adoption | Year of adoption | 2016-17 | 2017-18 | 2015-16 or thereafter | Comparison Year | 2015-16 | 2016-17 | 2014-15 or thereafter | | | | |
| | Phase I | Phase II | Voluntary Adoption | | | | | | | | | | | | | | |
| Year of adoption | 2016-17 | 2017-18 | 2015-16 or thereafter | | | | | | | | | | | | | | |
| Comparison Year | 2015-16 | 2016-17 | 2014-15 or thereafter | | | | | | | | | | | | | | |
| | <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 15%;">Companies Covered</th> <th style="width: 35%;">Phase I</th> <th style="width: 30%;">Phase II</th> <th style="width: 20%;">Voluntary Adoption</th> </tr> </thead> <tbody> <tr> <td>Listed Companies</td> <td>Companies having net worth \geqINR 500 Crores</td> <td>All companies Listed or in process of being listed</td> <td>Any company who Voluntary Adopts IND AS</td> </tr> <tr> <td>Un-Listed Companies</td> <td>Companies having net worth \geqINR 500 Crores</td> <td>Companies having net worth \geqINR 250 Crores</td> <td></td> </tr> <tr> <td>Grouped</td> <td>Applicable to holding,</td> <td></td> <td></td> </tr> </tbody> </table> | Companies Covered | Phase I | Phase II | Voluntary Adoption | Listed Companies | Companies having net worth \geq INR 500 Crores | All companies Listed or in process of being listed | Any company who Voluntary Adopts IND AS | Un-Listed Companies | Companies having net worth \geq INR 500 Crores | Companies having net worth \geq INR 250 Crores | | Grouped | Applicable to holding, | | |
| Companies Covered | Phase I | Phase II | Voluntary Adoption | | | | | | | | | | | | | | |
| Listed Companies | Companies having net worth \geq INR 500 Crores | All companies Listed or in process of being listed | Any company who Voluntary Adopts IND AS | | | | | | | | | | | | | | |
| Un-Listed Companies | Companies having net worth \geq INR 500 Crores | Companies having net worth \geq INR 250 Crores | | | | | | | | | | | | | | | |
| Grouped | Applicable to holding, | | | | | | | | | | | | | | | | |

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| Companies | Subsidiary Joint venture or Associate Company covered in (a) and(b) above This may also apply fellow subsidiary companies while preparing CFS of the holding companies | | |
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Exemptions– The insurance companies, banking companies and non-banking finance companies, company listed at SME Stock Exchange. shall not be required to apply Indian Accounting Standards (Ind AS) for preparation of their financial statements either voluntarily or mandatorily as specified in sub-rule (1) of rule 4.

Gaap generally accepted accounting principles ia a collections of commonly followed accounting rules and standards for financial reporting





SECTION 188

“related party”, with reference to a company, means—

- (i) a director or his relative;
- (ii) a key managerial personnel or his relative;
- (iii) a firm, in which a director, manager or his relative is a partner;
- (iv) a private company in which a director or manager or his relative is a member or director;
- (v) a public company in which a director or manager is a director and holds along with his relatives, more than **two per cent.** of its paid-up share capital;
- (vi) any **body corporate** whose Board of Directors, managing director or manager is accustomed **to act in accordance with the** advice, directions or instructions of a **director or manager**;
- (vii) any person on whose advice, directions or instructions a director or manager is accustomed to act: Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;
- (viii) Any Body Corporate which is
 - (a) A holding, subsidiary or an associate company of such company.
 - (b) A subsidiary or a holding company to which it is also a subsidiary, or
 - (c) An investing company or the venturer of the Company.
- (ix) such other person as may be prescribed;

Provided that clause (ix) will not apply to a private company. (Amendment)

“relative”, with reference to any person, means any one who is related to another, if—

- (i) **they are members of a Hindu Undivided Family;**
- (ii) **they are husband and wife; or**
- (iii) one person is related to the other in such manner as may be prescribed; The Rules prescribed as under:

A person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely:-

 - (1) **Father:** Provided that the term “Father” includes step-father.
 - (2) **Mother:** Provided that the term “Mother” includes the step-mother.
 - (3) **Son:** Provided that the term “Son” includes the step-son.
 - (4) **Son’s wife. (Explanation :- For the purpose of this clause, “the investing company or the venturer of a company” means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporates.)**
 - (5) **Daughter.**
 - (6) **Daughter’s husband.**
 - (7) **Brother:** Provided that the term “Brother” includes the step-brother;
 - (8) **Sister:** Provided that the term “Sister” includes the step-sister. **Exceptions:**

- Person giving advise, directors or instructions in a professional capacity will not be deemed to be a ‘related party’

- transactions entered into by the company in the ordinary course of their business if such transactions are on arm's length basis:

OR in GM NOT REQUIRED IF the transactions is entered between holding and 100% subsidiary. 5th proviso to sec 188(1)

"The requirement of passing the resolution under first proviso shall not be applicable for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval inserted by Companies (Amendment) Act 2015."

MCA Circular on Government Companies

"The related party transaction between two Government companies are exempted from obtaining approval by ordinary and Board resolution "

IF a Co. is required to form an audit committee then audit committee approval required.

(1) BR at BM before entering into RPT. 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 prescribed below, **no company shall enter into**

any contract or arrangement with a related party with respect to--

(a) sale, purchase or supply of any goods or materials;

(b) selling or otherwise disposing of, or buying, property of any kind;

(c) leasing of property of any kind;

(d) availing or rendering of any services;

(e) appointment of any agent for purchase or sale of goods, materials, services or property;

(f) such **related party's appointment to any office or place of profit** in the company, its subsidiary company or associate company; and

(g) **underwriting the subscription of any securities** or derivatives thereof, of the company:

(2) Prior **ordinary resolution** if certain limits on the next page are crossed.

(3) Register as per MBP-4 (sec 189)

(4) Disclosures in board's report.

Step 1 and Step 2 not required if RPT transaction is in ordinary course of business and at arm's length in case of unlisted companies. But details to be entered in MBP-4.

If a listed Co. enters into Material RPT OR in GM required even if transaction is in ordinary course of business AND at arm's length (Refer Q-2)

Definition of Material Related Party transactions as per SEBI LODR Regulations.

provided that no members shall vote at shareholders meeting if such member is a related party

Provided also that nothing contained in the second proviso shall apply to a company in which ninety per cent

or more members, in number, are relatives of promoters or are related parties.

CONDITIONS:

A company shall enter into any contract or arrangement with a related party subject to the following conditions, namely:-

(1) The agenda of the Board meeting at which the resolution is proposed to be moved shall **disclose prescribed matters**

Nef of Material Related Party transaction as per SEBI LODR Regulations.

(2) Where any director is interested in any contract or arrangement with a related party, such director shall

not be present at the meeting during discussions on the subject matter of the resolution relating to such

contract or arrangement-

Exemption: In case of private companies, interested director may participate on Board Meeting in which

such contracts or arrangement is going to be discussed where he is interested after disclosure of interest.

Even in case of IFSC public company director can vote after disclosure of interest.

a company shall not enter into a transaction or transactions, where the transaction or transactions to be entered

into -

(a) as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of section 188 with criteria, as mentioned below –

AMENDMENTS ON 18-11-2019

| | |
|---|--|
| NATURE OF RELATED PARTY TRANSACTION | |
| For Every Transaction | |
| Sale, purchase or supply of any goods or materials directly or through appointment of agents (or) | Amounting to 10% of Turnover of Company |
| Selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agents (or) | Amounting to 10% of Net worth |
| Leasing of property of any kind (or) | Amounting to >_ 10% of Turnover of Company |
| Availing or rendering of any services directly or through appointment of agents (or) | Amounting 10 % of Turnover of company |
| Appointment to any office or place of profit in the company, its subsidiary company or associate company (or) | > 2.5 Lacs Per Month |
| Remuneration for underwriting the subscription of any securities or derivative | > 1% of Network |

If a listed company is entering into RPT for them this value will apply + even SEBI LODR

Note: **The Transaction value has to be checked cumulatively for one financial year.**

- Turnover and Net worth as per Audited Financial Statement of Preceding Financial Year.
- If any member is interested in any transaction, than such member shall not cast vote in meeting regarding such resolution .
- It is here by clarified that the limits specified in sub-clause (i) to (iv) shall apply for Transaction and transactions to be entered into either individually or taken together with previous transactions during a financial year.

(b) appointment to any office or place of profit in the company, its subsidiary company or associate company

at a monthly **remuneration exceeding two and half lakh rupees** as mentioned in clause (f) of sub-section

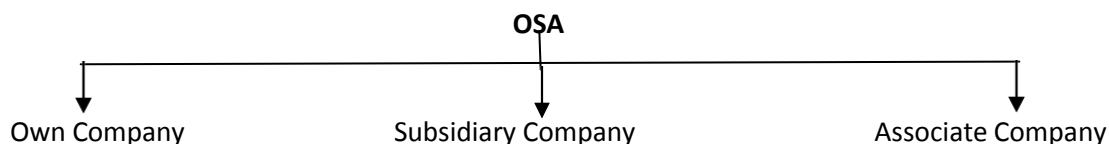
on

(!) of section 188; or

Office or place of Profit

Audit Committee approval BR + OR in GM

Amitabh Bachhan is director of X Ltd. His son Abhishek was appointed as production manager/ finance manager/ HR manger of X Ltd. @ 5/7 lac per month. We will say Abhishek is holding office or place of profit



(c) remuneration for underwriting the subscription of any securities or derivatives thereof of the company **exceeding one percent. of the net worth** as mentioned in clause (g) of sub section (!) of section 188.

Explanation. - (!) The Turnover or Net Worth referred in the above sub-rules shall be on the basis of the Audited Financial Statement of the preceding Financial year.

(3) In case of wholly owned subsidiary, the ordinary resolution passed by the holding company **shall be sufficient for the purpose** of entering into the transactions **between wholly owned subsidiary and holding company.**

(4) The explanatory statement to be annexed to the notice of a general meeting convened pursuant to section 101 shall contain the following particulars namely:-

- (a) name of the related party ;
- (b) name of the director or key managerial personnel who is related, if any;
- (c) nature of relationship;
- (d) nature, material terms, monetary value and particulars of the contract or arrangement; any other information relevant or important for the members to take a decision on the proposed resolution .

Provided further that no member of the company shall vote on such resolution , to approve any contract or arrangement which may be entered into by the company, if such member is a related party (Not Applicable to Private Company) w.e.f 5-6-2015.

Provided also that nothing contained in the second proviso shall apply to a company in which ninety percent or more members, in number, are relatives of promoters or are related parties.

Provided also that nothing in this sub-section shall apply to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis. It means that neither BR or ordinary resolution required.

Explanation.--In this sub-section,--

(a) the expression "**office or place of profit**" means any office or place--

(i) where such office or place is held **by a director**, if the director holding it **receives from the** company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

(ii) where such office or place is held **by an individual other than a director** or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

(b) the expression "**arm's length transaction**" means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

(3) Every contract or arrangement entered into under sub-section (1) shall be referred to in the Board's report

to the shareholders along with the justification for entering into such contract or arrangement.

(4) Where any contract or arrangement is entered into by a director or any other employee, without obtaining

the consent of the Board or approval by a **ordinary** resolution in the general meeting under sub-section

(1) and if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, such contract or arrangement shall be **voidable at the option of the Board or as the case may be of the shareholder** and if

the contract or arrangement is with a related party to any director, or is authorised by any other director,

the directors concerned shall indemnify the company against any loss incurred by it.

(5) Without prejudice to anything contained in sub-section (3), it shall be open to the company to proceed

against a director or any other employee who had entered into such contract or arrangement in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.

(i) Any **director** or any other employee of a company, who had entered into or authorised the contract or arrangement in **violation of the provisions** of this section shall,--

(ii) 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 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.

Q1) A company named Reliance Industries Limited enters into purchase / sale of goods with its director Anil Ambani. The value of the transaction is 150 cr. The turnover of the company is ` 2000 cr. What are the legal compliance that a company will have to do?

Ans: As per section 188 of the Companies Act, 2013, when a company enters into a contract with a related party for purchase / sales of goods, then certain formalities are to be done. As Anil Ambani (director of the company) is a related party, following steps are to be done:-

Step 1 :- Audit Committee Approval to be obtained. Sec 177

Step 2 :- Prior Board resolution at board meeting to be passed assuming transaction is not at arm's length basis and not in ordinary course of business.

Step 3 :- Prior Ordinary resolution at general meeting

If RPT > 10% of turnover of the company or 100 cr. [whichever is lower]

Therefore prior OR is required because RPT > 100 cr. [lower of the two].

Step 4 :- Directors Report shall contain the reason for entering such contracts.

Step 5 :- Details of such contracts must be entered in a separate register as per Section 189.

If RPT is in ordinary course and at arm's length, then step 2 and 3 is not required.

SOME EXAMINATION QUESTIONS

1. Suggest some measures to increase auditors' effectiveness?
2. What is NFRA? What is the need of NFRA? What intent is it trying to serve?
3. Which all entities are governed by NFRA? What are the powers and functions of NFRA?
4. What is whistle blowing? Types of Whistleblowers.
5. Write the provisions for mandatory rotation of auditors in India.
6. Does having an independent audit prevent scams? Justify your answer.
7. Write a short note on Internal Audit.
8. Explain in brief the provisions and importance of secretarial audit.

CHAPTER 8
Corporate Governance and Shareholders Rights

| | |
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| PROMOTER: | <p>A promoter is a person, firm or company who does the preliminary work for the formation of a company, including</p> <ul style="list-style-type: none"> ➤ Framing its memorandum and articles of association, ➤ Its incorporation process and initial raising of capital for business. <p><u>Securities Exchange Commission Rule of US 405</u> (a) defines promoter as a “person who acting alone or in conjunction with other persons directly or indirectly takes the initiative in founding or organizing the business enterprise.</p> <p>A promoter is neither a trustee nor an agent of the company but he has a fiduciary relationship with the company. Fiduciary relation means a relation of trust and confidence.</p> |
| Companies Act, 2013: According to Sec 2 (69) of Companies Act, 2013 | <p>a “promoter” means a person—</p> <ul style="list-style-type: none"> ➤ who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or ➤ who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or ➤ In accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act. |
| Role and Liabilities of Promoters | <p>Role and Liabilities of Promoters As per The Companies Act, 2013:</p> <ul style="list-style-type: none"> ➤ Officer in Default : Under Section 2(59) and Section 2(60) any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act can be treated as an officer in default. Thus promoter if found in default of provisions of the act may be penalised with fine or punished by imprisonment. ➤ Incorrect information during incorporation: Promoters shall be liable if they furnish any false or incorrect information in the documents filed at the time of registration of the company. ➤ False or misleading Prospectus: Promoters who authorise a prospectus which is untrue or misleading are subject to criminal liability (Sec 34) and civil liability and are required to pay compensation to every person who has sustained loss or damage because of such prospectus. (Sec 35) ➤ Contravention of Provisions of Raising Equity Capital: Similarly if the promoters contravene any provisions of the act while issuing prospectus or during private placement they may be penalised or imprisoned. ➤ Improper Notice of General Meeting: Section 102 deals with the |

| | |
|--|--|
| | <p>matters relating to “Statement to be annexed to notice”. Its sub-section (5) states that if any default is made in complying with the provisions of this section, every promoter, director, manager or other key managerial personnel who is in default shall be punishable with fine which may extend to fifty thousand rupees or five times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is more.</p> |
|--|--|

MAJORITY AND MINORITY SHAREHOLDERS:

When an **individual, organization or group of shareholders together hold or control more than 50% shares of the company** they are known as **majority shareholders**. If a company has a majority shareholder then **all other shareholders become minority shareholders** as they hold less than 50% shares.

The interests, goals, and investment horizons of majority shareholders may vary from minority shareholders. Majority shareholder may decide on investing company surplus in a new risky venture whereas minority shareholders may prefer return in the form of dividends. A proper balance of the rights of majority and minority shareholders enables efficient functioning of the company.

PROTECTION OF RIGHTS OF SHAREHOLDERS/INVESTORS IN INDIA:

Securities and Exchange Board of India (**SEBI**) is the **capital market regulator** and nodal agency in India who regulates the security market. One of the **objectives of the SEBI** is to provide a degree of **protection to the investors 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 (Prohibition of Insider Trading) Regulations 2015.**
- **SEBI has set up a separate cell to address the grievances of investors - SEBI Complaints Redressal System (SCORES).**

SECTION 125 INVESTOR EDUCATION AND PROTECTION FUND

| Core areas | Provisions |
|------------------------------------|--|
| Cg shall establish the fund | (1) The Central Government shall establish a Fund to be called the Investor Education and Protection Fund (herein referred to as the Fund). |
| Amount credited to the fund | (2) There shall be credited to the Fund-- (a) the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund; |

| | |
|--|--|
| | <p>(b) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;</p> <p>(c) the amount in the Unpaid Dividend Account of companies transferred to the Fund under subsection (5) of section 124;</p> <p>(d) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956 (1 of 1956), as it stood immediately before the commencement of the Companies (Amendment) Act, 1999 (21 of 1999), and remaining unpaid or unclaimed on the commencement of this Act;</p> <p>(e) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956 (1 of 1956);</p> <p>(f) the interest or other income received out of investments made from the Fund;</p> <p>(g) the amount received under sub-section (4) of section 38;</p> <p>(h) the application money received by companies for allotment of any securities and due for refund;</p> <p>(i) matured deposits with companies other than banking companies;</p> <p>(j) matured debentures with companies;</p> <p>(k) interest accrued on the amounts referred to in clauses (h) to (j);</p> <p>(l) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;</p> <p>(m) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and</p> <p>(n) such other amount as may be prescribed:</p> <p>Provided that no such amount referred to in clauses (h) to (j) shall form part of the Fund unless such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment</p> |
|--|--|

| Core areas | Provisions |
|-------------------------|--|
| Utilization of the fund | <p>(3)(a) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;</p> <p>(b) promotion of investors' education, awareness and protection;</p> <p>© distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;</p> <p>(d) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as</p> |

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| | <p>may be sanctioned by the Tribunal; and</p> <p>(e) any other purpose incidental thereto, in accordance with such rules as may be prescribed:</p> <p>Provided that the person whose amounts referred to in clauses (a) to (d) of sub-section (2) of section 205C transferred to Investor Education and Protection Fund, after the expiry of the period of seven years as per provisions of the Companies Act, 1956 (1 of 1956), shall be entitled to get refund out of the Fund in respect of such claims in accordance with rules made under this section.</p> <p>Explanation.--The disgorged amount refers to the amount received through disgorgement or disposal of securities.</p> |
| Application for money transferred to IEPF | (4) Any person claiming to be entitled to the amount referred in sub-section (2) may apply to the authority constituted under sub-section (5) for the payment of the money claimed. |
| CG shall establish Authority | (5) The Central Government shall constitute, by notification, an authority for administration of the Fund consisting of <ul style="list-style-type: none"> • chairperson and • such other members, not exceeding seven and • chief executive officer, as the Central Government may appoint. |
| Administration of the fund | (6) The manner of administration of the Fund, appointment of chairperson, members and chief executive officer, holding of meetings of the authority shall be in accordance with such rules as may be prescribed. |
| Officers and resources | (7) The Central Government may provide to the authority such offices, officers, employees and other resources in accordance with such rules as may be prescribed. |
| Separate accounts of the fund | 8) The authority shall administer the Fund and maintain separate accounts and other relevant records in relation to the Fund in such form as may be prescribed after consultation with the Comptroller and Auditor-General of India. |

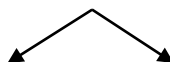
| Core areas | Provisions |
|---------------------------------------|---|
| Utilization of fund | (9) It shall be competent for the authority constituted under sub-section (5) to spend money out of the Fund for carrying out the objects specified in sub-section (3). |
| Audit of account by C & AG | (10) The accounts of the Fund shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and such audited accounts together with the audit report thereon shall be forwarded annually by the authority to the Central Government. |

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|---------------------------------|---|
| Report to cg on the fund | (11) The authority shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report and the audit report given by the Comptroller and Auditor-General of India to be laid before each House of Parliament. |
|---------------------------------|---|

RULE 3 TRANSFER OF SHARES

| | PHYSICAL SHARES | DEMAT SHARES |
|---|------------------------|---------------------|
| CO.TO ISSUE ADVERTISEMENT IN ENGLISH AND VERNACULAR LANGUAGE | Yes | Yes |
| SIMULTANEOUSLY INFORM SHAREHOLDERS PRIOR TO 3 MONTHS OF TRANSFER | Yes | Yes |
| CO.TO AUTHORISED CS/OTHER PERSON TO EXECUTE DOCUMENTS | Yes | Yes |

Shares will be transferred to IEPF demat account



NSDL Punjab national
bank

CDSL SBI

CO. TO FILE IEPF-2 WITHIN 90 DAYS OF AGM EVERY YEAR STATEMENT OF UNCLAIMED DIVIDEND AS ON AGM DATE

SOME SHARES MAY NOT BE TRANSFERRED :- IEPF- 3

1. Where the court / tribunal / statutory authority has ordered not to transfer the shares
2. Shares pledged / hypothecated

Note 1:- for shares which are not transferred form iepf-3 within 30days from the end of financial year

Note 2:- for transfer of shares to IEPF:-form IEPF4

**Investor Education and Protection Fund Authority(Accounting, Audit, Transfer and Refund)Second
Amendment Rules, 2019**

“(1) Any amount required to be credited by the companies to the Fund as provided under clauses (a) to (n) of sub-section (2) of section 125 of the Act shall be remitted online along with a Statement in Form No. IEPF 1 containing details of such transfer to the Authority within a period of thirty days of such amounts becoming due to be credited to the Fund.” ;

(ii) sub-rules (2), (3) and (4) shall be omitted ;

(iii) After sub-rule (4),the following sub-rule shall be inserted, namely:-

“(4A) The companies which have transferred any amount referred to in clauses (a) to (d) of sub-section (2) of section 205C of the Companies Act, 1956 (1 of 1956) to Investor Education and Protection Fund or Central Government, but have not filed the statement or have filed the statement in any format other than in excel template, as required under sub-rule (1) of rule 5, shall submit details mentioned in sub-rule (1) of rule 5 in Form No. IEPF – 1A along with excel template within sixty days of notification of these amended rule.”;

(iv) in sub-rule (6), for clause (c), the following clause shall be substituted, namely:- “(c) The company shall maintain the record filed under sub – rule (1) in the same format along with all supporting documents and the Authority shall have the powers to inspect such records.”;

(v) for sub-rule (8), the following sub-rule shall be substituted, namely:-

“(8) Every company shall within a period of sixty days after the holding of Annual General Meeting or the date on which it should have been held as per the provisions of section 96 of the Act, whichever is earlier and every year thereafter till completion of the seven years period, identify the unclaimed amounts, as referred in subsection (2) of section 125 of the Act, as on the date of closure of financial year the account of which are to be adopted in the Annual General Meeting as per sub-section (1) of section 137 of the Act, separately furnish and upload on its own website and also on website of Authority or any other website as may be specified by the Government, a statement or information of unclaimed and unpaid amounts separately for each of the previous seven financial years through Form No. IEPF-2,

(5) While effecting such transfer, the company shall send a statement to the Authority in Form No. IEPF-4 within thirty days of the corporate action taken under clause (c) of sub-rule (3) of rule 6 containing details of such transfer and the company shall also attach a copy of the public notice published under clause (a) of sub-rule (3) of rule 6 in Form No IEPF-4.” .

(iv) for sub-rule (7), the following sub-rule shall be substituted, namely:-

“(7)The company shall maintain all such statements filed under sub – rule (5) in the same format along with all supporting documents and the Authority shall have the powers to inspect such records.”;

(v) for sub-rule (8), the following sub-rule shall be substituted, namely:- “(8) All benefits accruing on

such shares like bonus shares, split, consolidation, fraction shares and the like except right issue shall also be credited to such DEMAT account [by the company which shall send a statement to the Authority in Form No. IEPF-4 within thirty days of the corporate action containing details of such transfer.]”.

6. In the Principle rules, in rule 7,

(i) for sub-rule (2), the following sub-rule shall be substituted, namely:- “(2) Upon submission, Form No. IEPF-5 shall be transmitted online to the Nodal Officer of the company for verification of claim: Provided that the claimant after making an application in Form No. IEPF-5 under sub rule 1, shall send original physical share certificate, original bond, deposit certificate, debenture certificate, as the case may be, along with Indemnity Bond, Advance Receipts, any other document as enumerated in Form No. IEPF-5, duly signed by him, to the Nodal Officer of the concerned company at its registered office for verification of the claim.”;

(ii) for sub-rule (2A), following sub-rule shall be substituted, namely:-

“(2A) Every company which is required to credit amounts or shares to the fund or has deposited the amount or transferred the shares to the Fund shall nominate a Nodal Officer, who shall either be a Director or Chief financial Officer or Company Secretary of the company, for the purposes of verification of claims and coordination with Investor Education and Protection Fund Authority:

Provided that a company may appoint one or more Officer as Deputy Nodal Officer to assist the Nodal Officer for the purposes of verification of claim and for coordination with Investor Education and Protection Fund Authority:

Provided further that the Nodal Officer shall be solely liable for all actions of any officer appointed as Deputy Nodal Officer:

Provided also that in case a company fails to appoint Nodal Officer, every director of the company shall be deemed to be nodal officer and be liable for any failure to comply with requirement of these rules.”;

(iii) after sub-rule (2A), the following sub-rule shall be inserted, namely:-

“(2B) The details of the Nodal Officer and Deputy Nodal Officer duly indicating his or her designation, postal address, telephone and mobile number and company authorized e-mail ID shall be communicated to the Investor Education and Protection Fund Authority in Form No. IEPF – 2 within fifteen days from the date of publication of these rules and the company shall display the name of Nodal Officer and his e-mail ID on its website:

Provided that any change in the Nodal Officer or his details shall be communicated to the Authority through Form No. IEPF-2 within seven days of such change along with board resolution thereof.”;

(iv) for sub-rule (3), the following sub-rule shall be substituted, namely:-

“(3) The company shall, within thirty days from the date of receipt of claim, send an online verification report to the Authority after verification of details in Form No. IEPF-5 in the format specified by the Authority along with all the documents submitted by the claimant and shall attach the scanned copy of

all the original documents submitted by the claimant in physical form duly certified by its Nodal Officer alongwith the e-verification report along with a scanned copy of both sides of original physical share certificate or original bond or deposit or debenture certificate/s duly cancelled and certified:

Provided that if the online verification report is not sent by the company within thirty days of filing of claim, the company may do so by paying additional fee of fifty rupees for every day subject to maximum of two thousand and five hundred rupees:

Provided further that the company shall be liable to maintain the original documents submitted to it by the claimant and shall produce such documents whenever required: Provided also that in case of non-receipt of verification report along with documents by the Authority after the expiry of sixty days from the date of filing of Form No. IEPF-5, the Authority may reject Form No. IEPF-5, after sending a communication to the claimant and the concerned company, on the e-mail address of the claimant and the company, to furnish response within a period of fifteen days:

Provided also that for failure to submit verification report of the claim in accordance with these rules, the company and its Nodal Officer shall be punishable as per the provisions of the Act.

(v) for sub-rule (7), the following sub-rule shall be substituted, namely:-

“(7) Where the Authority, on examining any application for claim, finds it necessary to call for further information or finds such application or e-form or document to be defective or incomplete in any respect, the Authority shall give intimation of such information called for or defects or incompleteness, by e-mail on the email address of the claimant and the company, which has filed such application or e-form or document, directing him or it to furnish such information or to rectify such defects or incompleteness or to re-submit such application or e-Form or document within fifteen days from the date of receipt of such communication, failing which the Authority may reject the claim or e-form No. IEPF-5:

Provided that if such information or incompleteness is called from the claimant, he shall file the e-form and shall send such documents as called for within fifteen days, duly signed by him, to the Nodal Officer of the concerned company at its registered office for verification of the claim and company shall send a revised verification report:

Provided further that if any such information or incompleteness is called from the company, the company shall file the revised verification report and shall send such documents as called for within thirty days:

Provided also that the provisions of sub-rule (3) of rule 7 shall apply mutatis mutandis to this sub-Rule.”; (vi) for sub-rule (8), the following shall be substituted, namely:-

“(8) In case, claimant is a legal heir or successor or administrator or nominee of the registered share holder, the claimant shall ensure to submission of self-attested scanned copy of all documents detailed in Schedule II of these rules online along with the Form No. IEPF-5:

Provided that in case of loss of securities held in physical form, he has to ensure to submission of self-attested scanned copy of additional documents detailed in Schedule III of these rules online along with

the Form No. IEPF-5:

Provided further that the claimant shall submit in original all these documents duly signed by him, to the Nodal Officer of the concerned company at its registered office for verification of the claim.”;

(vii) in sub-rule (9), after the words “the claim of such claimant”, the following shall be inserted, namely:- “through its e-verification report:

Provided that the authority shall dispose such request of transfer or transmission based on the e-verification report of the company subject to verification of such request.”;

(ix) in sub-rule (11), after clause (a), the following clause shall be inserted, namely:-

“(b)Any fraudulent claim by the claimant shall be deemed to be fraud within the meaning of section 447 of the Act and the claimant shall be liable accordingly.

(c) If any person deceitfully personates an owner of any security or of any share warrant or coupon issued in pursuance of this Act and thereby files any claim to obtain or attempts to obtain any such security or interest or any such warrant or coupon due to the lawful owner, he shall be punishable under sections 57, 447 and 448 of the Act.”.

INVESTOR ASSOCIATIONS:

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

The Investors’ Association shall conduct workshops **under SEBI IEPF in the state in which their registered office is located subject to prior approval from the respective SEBI office at least 5 working days prior to date of the workshop**. The Investors’ Associations are eligible to claim reimbursement of the expenses incurred from SEBI subject to the conditions specified.

PROTECTION OF RIGHTS OF MINORITY SHAREHOLDERS

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|-----------------------------|--|
| OECD PRINCIPLES: | The corporate governance framework should protect and facilitate the exercise of shareholders’ rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders . All shareholders should have the opportunity to obtain effective redress for violation of their rights. |
| COMPANIES ACT ,2013: | Oppression and Mismanagement(SECTION 241-244) |

SECTION 241

APPLICATION TO TRIBUNAL FOR RELIEF CASES OF OPPRESSION, ETC:

- (1) 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, for an order under this Chapter.

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

In section 241 of the principal Act,—

- (a) in sub-section (2), the following proviso shall be inserted, namely:— “Provided that the applications under this sub-section, in respect of such company or class of companies, as may be prescribed, shall be made before the Principal Bench of the Tribunal which shall be dealt with by such Bench.”;

- (b) aGer sub-section (2), the following sub-sections shall be inserted, namely:— “

- (3) *Where in the opinion of the Central Government there exist circumstances suggesting that--*

- (a) **any person concerned in the conduct and management of the affairs of a company is or has been in connection therewith guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law or of breach of trust;**

- (b) **the business of a company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices;**

- (c) **a company is or has been conducted and managed by such person in a manner which is likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains; or**

- (d) **the business of a company is or has been conducted and managed by such person with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest, the Central Government may initiate a case against such person and refer the same to the Tribunal with a request that the Tribunal may inquire into the case and record a decision as to whether or not such person is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company.**

- (4) The person against whom a case is referred to the Tribunal under sub-section (3), shall be joined as a respondent to the application.

- (5) Every application under sub-section (3)—

- (a) shall contain a concise statement of such circumstances and materials as the Central Government may consider necessary for the purposes of the inquiry; and

- (b) shall be signed and verified in the manner laid down in the Code of Civil Procedure, 1908, for the signature and verification of a plaint in a suit by the Central Government.”.

- (1) 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.
- (2) Without prejudice to the generality of the powers under sub-section (1), an order under that sub-section may provide for—
- (a) the **regulation of conduct** of affairs of the company in future;
 - (b) the purchase of shares or interests of any members of the company by other members thereof or by the company;
 - (c) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital;
 - (d) *restrictions on the transfer or allotment of the shares of the company;*
 - (e) the termination, setting aside or modification, of any agreement, howsoever arrived at, between the company and the **managing director**, any other director or manager, **upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case;**
 - (f) the termination, setting aside or modification of any agreement between the company and any person **other than those referred to in clause (e):**
Provided that **no such agreement shall be terminated**, set aside or modified **except after due notice and after obtaining the consent of the party concerned;**
 - (g) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under this section, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference;
 - (h) *removal of the managing director, manager or any of the directors of the company;*
 - (i) **recovery of undue gains made by any managing director**, manager or director during the period of his appointment as such and the manner of utilisation of the recovery including transfer to Investor Education and Protection Fund or repayment to identifiable victims;
 - (j) the manner in which the managing director or manager of the company may be appointed subsequent to an order removing the existing managing director or manager of the company made under clause (h);
 - (k) *appointment of such number of persons as directors, who may be required by the Tribunal to report to the Tribunal on such matters as the Tribunal may direct;*
 - (l) imposition of costs as may be deemed fit by the Tribunal;
 - (m) any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made.

- (3) A certified copy of the order of the Tribunal under sub-section (1) shall be filed by the company with the Registrar within thirty days of the order of the Tribunal.
- (4) 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.

In section 242 of the principal Act, aGer sub-section (4), the following sub-section shall be inserted, namely:—“(4A) At the conclusion of the hearing of the case in respect of sub-section (3) of section 241, the Tribunal shall record its decision stating therein specifically as to whether or not the respondent is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company.”.

- (5) Where an order of the Tribunal under sub-section (1) makes any alteration in the memorandum or articles of a company, then, notwithstanding any other provision of this Act, the company shall not have power, except to the extent, if any, permitted in the order, to make, without the leave of the Tribunal, any alteration whatsoever which is inconsistent with the order, either in the memorandum or in the articles.
- (6) Subject to the provisions of sub-section (1), the alterations made by the order in the memorandum or articles of a company shall, in all respects, have the same effect as if they had been duly made by the company in accordance with the provisions of this Act and the said provisions shall apply accordingly to the memorandum or articles so altered.
- (7) A certified copy of every order altering, or giving leave to alter, a company's memorandum or articles, shall within thirty days aGer the making thereof, be filed by the company with the Registrar who shall register the same.
- (8) If a company contravenes the provisions of sub-section (5), the company shall be punishable with fine which shall not be **less than one 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 six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

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| Section 243 | CONSEQUENCE OF TERMINATION OR MODIFICATION OF CERTAIN AGREEMENTS. |
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- (1) Where an order made under section 242 terminates, sets aside or modifies an agreement such as is referred to in sub-section (2) of that section,—
 - (a) such order shall not give rise to any claims whatever against the company by any person for damages or for compensation for loss of office or in any other respect either in pursuance of the agreement or otherwise;

In section 243 of the principal Act,— (a) aGer sub-section (1), the following sub-sections shall be inserted, namely:— “

(1A) The person who is not a fit and proper person pursuant to sub-section (4A) of section 242 shall not hold the office of a director or any other office connected with the conduct and management of the affairs of any company for a period of five years from the date of the said decision:

Provided that the Central Government may, with the leave of the Tribunal, permit such person to hold any such office before the expiry of the said period of five years.

(1B) Notwithstanding anything contained in any other provision of this Act, or any other law for the time being in force, or any contract, memorandum or articles, on the removal of a person from the

office of a director or any other office connected with the conduct and management of the affairs of the company, that person shall not be entitled to, or be paid, any compensation for the loss or termination of office.”;

- (b) in sub-section (2), after the word, brackets and figure “sub-section (1)”, the words, brackets, figure and letter “or sub-section (1A)”
- (c) no managing director or other director or manager whose agreement is so terminated or set aside shall, for a period of five years from the date of the order terminating or setting aside the agreement, **without the leave of the Tribunal**, be appointed, or act, as the managing director or other director or manager of the company:

Provided that the Tribunal shall not grant leave under this clause unless notice of the intention to apply for leave has been served on the Central Government and that Government has been given a reasonable opportunity of being heard in the matter.

- (2) Any person who knowingly acts as a managing director or other director or manager of a company in contravention of clause (b) of sub-section (1), and every other director of the company who is knowingly a party to such contravention, shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to five lakh rupees, or with both.

Section 244

RIGHT TO APPLY UNDER SECTION 241:

- 1) 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.

- (2) 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

CLASS ACTION:

- (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—
 - (i) 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;
 - (ii) 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
 - (iii) 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;
 - (h) 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 preceded 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) Authorized 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).

Section 246

APPLICATION OF CERTAIN PROVISIONS TO PROCEEDINGS UNDER SECTION 241 OR SECTION 245:

The provisions of sections 337 to 341 (both inclusive) shall apply mutatis mutandis, in relation to an application made to the Tribunal under section 241 or section 245.

| TOOLS USED BY INSTITUTIONAL INVESTORS: | |
|---|---|
| The Institutional Investors use different tools to assess the health of Company before investing resources in it. Some of the important tools are discussed as under: | |
| One-to-one meetings: | The meetings between institutional investors and companies are extremely important as a means of communication between the two parties. A company will usually arrange to meet with its largest institutional investors on a one-to-one basis during the course of the year. |
| Voting: | The right to vote can be seen as fundamental tools for some element of control by shareholders. They should use their power judiciously. The institutional investors can register their views by postal voting, or, vote electronically where this facility is available. |
| Focus list: | 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. |
| 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). 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. |

| UK Stewardship Code | |
|---------------------|--|
| OBJECTIVE: | The Stewardship Code is a part of UK company law concerning principles that institutional investors are expected to follow .Its principal aim is to make institutional investors ,who manage other people money , be active and engage in corporate governance in the interest of their beneficiaries . For investors, stewardship is more than just voting . Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance , including culture and remuneration . Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings. |
| PRINCIPLES: | <ol style="list-style-type: none"> 1. Publicly disclose their policy on how they will discharge their stewardship responsibilities. 2. Have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed. 3. Monitor their investee companies. 4. Establish clear guidelines on when and how they will escalate their stewardship activities. 5. Be willing to act collectively with other investors where appropriate. 6. Have a clear policy on voting and disclosure of voting activity. 7. Report periodically on their stewardship and voting activities. |

| Principles for Responsible Investment (PRI) |
|---|
| <ol style="list-style-type: none"> 1. We will incorporate ESG issues into investment analysis and decision-making processes. 2. We will be active owners and incorporate ESG issues into ownership policies and practices. 3. We will seek appropriate disclosure on ESG issues by the entities in which they invest. |

4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance effectiveness in implementing the Principles.
6. We will each report on their activities and progress towards implementing the Principles.

Code for Responsible Investing in South Africa (CRISA):

The Code for Responsible Investing in **South Africa (CRISA)** gives guidance on how the institutional investor should execute investment analysis and investment activities and exercise rights so as to promote sound governance.

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| APPLICABLE: | <p>CRISA applies to:</p> <ul style="list-style-type: none"> • Institutional investors as asset owners, for example, pension funds and insurance companies. • Service providers of institutional investors, for example, asset and fund managers and consultants. |
| PRINCIPLES: | <ol style="list-style-type: none"> 1. An institutional investor should incorporate sustainability considerations, including ESG, into its investment analysis and investment activities as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries. 2. An institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities. 3. Where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the principles of CRISA and other codes and standards applicable to institutional investors. 4. An institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should pro-actively manage these when they occur. 5. Institutional investors should be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments. |

California Public Employees' Retirement System:

The California Public Employees' Retirement System (CalPERS, System) is the largest U.S. public pension fund, with assets totaling approximately \$300 billion spanning domestic and international markets as of June 30, 2014.

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|-------------|---|
| MISSION: | Its mission is to provide responsible and efficient stewardship of the System to deliver promised retirement and health benefits, while promoting wellness and retirement security for members and beneficiaries. |
| PRINCIPLES: | <ul style="list-style-type: none"> ➤ Sustainability ➤ Director Accountability ➤ Transparency |

- **One-share/One-vote**
- **Proxy Materials**
- **Code of Best Practices**
- **Long-term Vision**
- **Access to Director Nominations**
- **Political Stability**

DEALING WITH INSTITUTIONAL INVESTORS:

The relationship **between companies and their investors both individual and institutional is very crucial**. Companies should consider implementing the following practices, while dealing with institutional investors.:

- Preparing (in advance) materials articulating positions vis-à-vis significant issues to be submitted to a **shareholder vote, addressing major rationales supporting a view contrary to the views the public company intends to espouse.**
- Contemporaneously **documenting proxy services firm responses to meeting requests**, as well as substantive discussions at any meeting.
- Formally requesting that **proxy services firms provide previews of recommendations they anticipate making vis-à-vis issues to be submitted to public company shareholders for a vote.**
- **Monitoring proxy services firm recommendations** for accuracy or reliance on outdated information.

ROLE OF PROXY ADVISORY FIRMS:

- Proxy advisors generally **offer variety of services consisting of both, analyzing the proposals at general meetings and recommending voting decisions.**
- The recommendations of **proxy advisors help the investors to obtain a more considered understanding of different agenda items and to arrive** at an informed voting decision, allowing them to optimise their own limited resources and cast their votes in a timely and informed manner.
- The proxy advisors can assist in **mitigating the language issues as well**. Further, they may also enable the investors to have a **voting platform in cases where electronic voting is a pre-requisite at general meetings.**
- Proxy advisers also **influence boards' decision making**. They do a good job of policing the boards and governance records of the firms they track, and nudging institutional investors to take a stand on governance issues.

GOVERNANCE OF GROUP ENTITIES/ SUBSIDIARIES

To protect the interest of shareholders of holding company and minority shareholders of subsidiary certain provisions have been put in **place both by the Companies Act, 2013 and SEBI (LODR)**.

- **At least one independent director** on the board of directors of the **listed company shall be a director on the board of directors of any unlisted material subsidiaries including foreign companies.**

- The **minutes of the meetings** of the board of directors of the **unlisted subsidiary** shall be placed at the **meeting of the board of directors of the listed company**.
- The **management of the unlisted subsidiary** shall periodically bring to the notice of the board of directors of the listed company, a **statement of all significant transactions** and arrangements entered into by the unlisted subsidiary.
- The **statutory auditor of a listed entity** shall undertake a **limited review** of the audit of all the entities/ companies whose accounts are to be **consolidated with the listed entity**. Besides **audited annual consolidated statements at least eighty percent of the quarterly consolidated financial results**, of each of the consolidated revenue, assets and profits, respectively, shall have been audited or subjected to limited review. **(Regulation 33)**
- The **audit committee of the listed company** shall also **review the financial statements**, of subsidiaries in particular, the investments made by the unlisted subsidiary. **(Regulation 24)** The board of a holding company can authorize anyone to Inspection of books of account of any subsidiary company. **(Section 128)**
- The listed company shall **not dispose of shares in its material subsidiary which would reduce its shareholding (either on its own or together with other subsidiaries) to less than 50%** or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting. **Exception** has been granted for divestment under a scheme of arrangement duly approved by a court/ tribunal. **(Regulation 24)**
- Every **listed entity's material unlisted subsidiaries incorporated in India** shall undertake **secretarial audit** and shall annex the report with its annual report. **(Regulation 24A)** This will help improve compliance of group as a whole.

EXPLANATION:

Significant transaction or arrangement” shall mean any **individual transaction or arrangement** that exceeds or is likely to **exceed ten percent (10%) of the total revenues or total expenses or total assets or total liabilities**, as the case may be, of the unlisted material subsidiary for the immediately preceding accounting year. **(Regulation 24).**

CORPORATE GOVERNANCE IN FAMILY OWNED ENTERPRISES

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

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

- **Corporate Social Responsibility** : Every company having **net worth of Rs. 500 Crores or more, turnover exceeding Rs. 1000 Crores or net profit of more than Rs. 5 Crore** is required to constitute a Corporate Social Responsibility Committee under **Section 135 of the Companies Act, 2013 constituting 3 or more directors with at least 1 Independent Director** to formulate policies and recommend activities that the company may undertake for promotion of education, gender equality, health, poverty eradication, environment, employment etc. Again, this measure puts responsibility on the company for the social wellbeing not just of its workforce, but also makes it publicly accountable.
- **Audit Committee** : The Act provides for the setting up of an Audit Committee comprising of at **least 3 directors by all listed companies, majority of which have to be independent directors**. The members of such a committee have to be persons who can **read and understand financial statements** and the task entrusted to such a committee is recommending remuneration and **appointments of auditors and reviewing their independence**.
- **Nomination and Remuneration Committee** : The Nomination and Remuneration committee **shall comprise of 3 or more non-executive directors out of which at least half shall be Independent Directors**. Such committee shall identify persons qualified to become directors of the company and make recommendations to the board of directors regarding their appointment and approval.
- **Serious Fraud Investigation Office** : **Section 211 of the Act** provides for the establishment of a Serious Fraud Investigation Office to look into the **affairs of the company and investigate incidences of fraud** upon receipt of report of the **Registrar or inspector** or generally in the public interest or request from any Department of Central or State Government.

Some Unique challenges/ Governance issues of family businesses:


- **Managing the diverse opinions** of family members in the business, solving internal issues and disputes, etc is a challenge.
- **Investors** – both shareholders and creditors – may look with distrust on family-controlled companies, because of the risk that the controlling family may abuse the rights of other shareholders. So investors likely to scrutinize such companies with care before taking the plunge and investing.
- **Hiring external staff** which may perceive that career advancement, freedom and decision-making are solely the purview of family.
- **Change in mind-set:** Differing views between the older generation and the newer generation
- **Lack of Competitiveness.**

SOME EXAMINATION QUESTIONS

1. Discuss about the provisions for protection of shareholder rights?
2. What are the tools that an institutional investor can use to assess the health of a company?
3. Discuss the major principles of UK Stewardship code?
4. Write a short note on IEPF.
5. Discuss the salient features of CalPERS. What are the main drivers of their corporate engagement programme ?
6. Write a note on Oppression and mismanagement.
7. What is the role of Proxy advisory firms?
8. Short note: Material Subsidiary.

CHAPTER 9

Corporate Governance and Other Stakeholders

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| <p>“Stakeholder Theory”</p> | <p>“Stakeholder Theory is an idea about how business really works. It says that for any business to be successful it has to create value for customers, suppliers, employees, communities and financiers, shareholders, banks and others people with the money. It says that you can’t look at any one of their stakes or stakeholders if you like, in isolation. Their interest has to go together, and the job of a manager or entrepreneur is to work out how the interest of customers, suppliers, communities, employees and financiers go in the same direction.</p>  <pre> graph TD S((Stakeholders of Company)) --> M((Management)) S --> LC((Local Community)) S --> C((Customers)) S --> E((Employees)) S --> Su((Suppliers)) S --> O((Owners)) </pre> |
| <p>RECOGNITION OF STAKEHOLDER CONCEPT IN LAW (UK & INDIA)</p> | <p>Under the UK Companies Act, 2006: Section 172: Duty to promote the success of the company: A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to</p> <ul style="list-style-type: none"> ➤ the likely consequences of any decision in the long term, ➤ the interests of the company’s employees, ➤ the need to foster the company’s business relationships with suppliers, customers and others, ➤ the need to act fairly as between members of the company <p>Under the Indian Companies Act, 2013: Section 135 Corporate Social Responsibilities: Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which</p> |

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| | <p>at least one director shall be an independent director.</p> <ul style="list-style-type: none"> ➤ Section 166(2) Duties of the Directors: A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment. ➤ Role and Functions of Independent Directors. <p>Under the Principles articulated under SEBI (LODR) Regulations, 2015:</p> <ul style="list-style-type: none"> ➤ Stakeholders should have the opportunity to obtain effective redress for violation of their rights. ➤ The listed entity should devise an effective whistle blower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices. |
| <p>STAKEHOLDER ENGAGEMENT</p> | <p>Stakeholder engagement is the process by which an organisation involves people who may be affected by the decisions it makes or can influence the implementation of its decisions. Stakeholder engagement</p> <ul style="list-style-type: none"> ➤ identifies stakeholders ➤ assesses stakeholder needs ➤ develops stakeholder relations plans and forms alliances with stakeholders. <p>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:</p> <ul style="list-style-type: none"> ➤ 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. <p>Stakeholder engagement involves following steps:</p> <ul style="list-style-type: none"> ➤ Identify stakeholder ➤ Establish the goals and objectives of the company for engagement. ➤ Identify stakeholder needs and interests. ➤ Determine the stakeholder engagement strategy. ➤ Evaluate outcome and internalize learnings. |

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| | <p>Key principles of Stakeholder engagement:</p> <ul style="list-style-type: none"> ➤ Communicate ➤ Consult ➤ Compromise ➤ Remember, they are human ➤ Relationship ➤ Take responsibility ➤ Simple but not easy ➤ Managing risk. |
| <p>STAKEHOLDER ANALYSIS</p> | <p>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.</p> <p>A stakeholder analysis of an issue consists of weighing and balancing all of the competing demands on a firm by each of those who have a claim on it, in order to arrive at the firm's obligation in a particular case. A stakeholder analysis does not preclude the interests of the stakeholders overriding the interests of the other stakeholders affected, but it ensures that all affected will be considered.</p> <p>Doing a stakeholder analysis can:</p> <ul style="list-style-type: none"> ➤ 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. |
| <p>BETTER STAKEHOLDER ENGAGEMENT ENSURES GOOD GOVERNANCE</p> | <p>The following are just some of the different roles that stakeholders can play:</p> <ul style="list-style-type: none"> ➤ 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; ➤ Co-implementers, such as NGOs, who have partnered with the company to implement a joint solution or program to address a shared challenge. |
| <p>TYPES OF STAKEHOLDERS</p> | <p>The concept of stakeholders may be classified into Primary and Secondary Stakeholders:</p> <ul style="list-style-type: none"> ➤ 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 |

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| | <p>and communities that provide necessary infrastructure.</p> <ul style="list-style-type: none"> ➤ 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. <p>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.</p> |
| <p>THE CAUX ROUND TABLE</p> | <ul style="list-style-type: none"> ➤ The Caux Round Table (CRT) is an international network of business leaders working to promote a morally and sustainable way of doing business. The CRT believes that its Principles for Responsible Business provide necessary foundations for a fair, free and transparent global society. ➤ The Caux Round Table was founded in 1986 by Frits Philips Sr, former President of Philips Electronics. ➤ The CRT began to focus attention on the importance of global corporate responsibility in reducing social and economic threats to world peace and stability. ➤ Caux Round Table Principles for Business around three ethical foundations, namely <ul style="list-style-type: none"> • responsible stewardship; • the Japanese concept of Kyosei • living and working for mutual advantage; and respecting and protecting human dignity. |
| <p>The CRT Principles for Responsible Business</p> | <ol style="list-style-type: none"> 1. PRINCIPLE 1 - RESPECT STAKEHOLDERS BEYOND SHAREHOLDERS 2. PRINCIPLE 2 – CONTRIBUTE TO ECONOMIC, SOCIAL AND ENVIRONMENTAL DEVELOPMENT 3. PRINCIPLE 3 – BUILD TRUST BY GOING BEYOND THE LETTER OF THE LAW 4. PRINCIPLE 4 –RESPECT RULES AND CONVENTIONS 5. PRINCIPLE 5 – SUPPORT RESPONSIBLE GLOBALISATION 6. PRINCIPLE 6 – RESPECT THE ENVIRONMENT 7. PRINCIPLE 7 – AVOID ILLICIT ACTIVITIES |
| <p>CRT Stakeholder Management Guidelines</p> | <p>key stakeholders are dependent on business for their well-being and prosperity. They are the beneficiaries of ethical business practices.</p> |

- 1. Customers:** A responsible business treats its customers with respect and dignity. Business therefore has a responsibility to:

 - **Provide customers with the highest quality products** and services consistent with their requirements.
 - Ensure that **the health and safety of customers** is protected.
 - Protect customers from **harmful environmental impacts of products and services.**

- 2. Employees:** A responsible business treats every employee with dignity and respects their interests. Business therefore has a responsibility to:

 - **Provide jobs and compensation** that contribute to improved living standards
 - Provide working conditions that protect each employee's health and safety.
 - **Avoid illicit or abusive child labor practices.**

- 3. Shareholders:** A responsible business acts with care and loyalty towards its shareholders and in good faith for the best interests of the corporation. Business therefore has a responsibility to:

 - **Disclose relevant information** to shareholders, subject only to legal requirements and competitive constraints.
 - **Conserve, protect, and increase shareholder wealth.**
 - Respect shareholder views, **complaints, and formal resolutions.**

- 4. Suppliers:** A responsible business treats its suppliers and subcontractors with fairness, truthfulness and mutual respect. Business therefore has a responsibility to:

 - Ensure that **business supplier and subcontractor activities are free from coercion and threats.**
 - **Share information** with suppliers and integrate them into business planning.

- 5. Competitors:**

 - **Foster open markets for trade and investment.**
 - **Respect both tangible and intellectual property rights.**
 - **Refuse to acquire commercial information** through dishonest or **unethical means**, such as industrial espionage.

- 6. Communities:**

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| | <ul style="list-style-type: none"> ➤ Respect human rights and democratic institutions, and promote them wherever practicable. ➤ Support peace, security and the rule of law. ➤ Respect social diversity including local cultures and minority communities. ➤ Be a good corporate citizen through ongoing community investment and support for employee participation in community and civic affairs. |
| <p>THE CLARKSON PRINCIPLES OF STAKEHOLDER MANAGEMENT</p> | <p>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.</p> <p>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.</p> <p>Principle 3: Managers should adopt processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>Principle 7: Managers should acknowledge the potential conflicts between</p> <ul style="list-style-type: none"> ➤ their own role as corporate stakeholders, and ➤ their legal and moral responsibilities for the interests of stakeholders, and <p>should address such conflicts through open communication, appropriate reporting and incentive systems, and, where necessary, third party review</p> |

**GOVERNANCE
PARADIGM AND
VARIOUS
STAKEHOLDERS**

1. **Employees:** Following are the some important example for ensuring good governance by employees:
 - **Right to consultation**
 - **Right to nominate/vote for supervisory board members**
 - **Participation in the capital:**
 - **Profit sharing**
 - **Whistle Blower Policy**

2. **Customers:** The business activity runs around the customer. There is a maxim '**Caveat Emptor**' means **let the buyer beware**. However, to run the business in long term, the concept has to re-think else the competitor will take advantage of it. Today the customer satisfaction is one of the most important aspects of firm's performance.

3. **Lenders:** Lenders normally are the banks and financial institutions. **They provide the term loan as well as the working capital.** While giving the credit facilities to any concerns, apart from the financial strength, project viability, income generation of the organization, lenders also like to ensure about the **other aspects like market reputation, compliance culture.**

4. **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.

5. **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.

6. **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.**

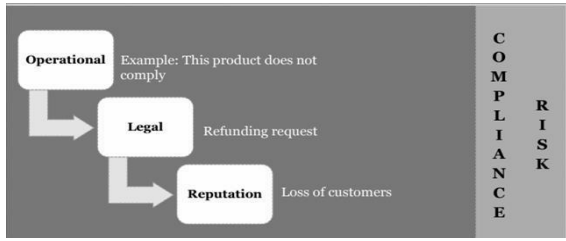
SOME EXAMINATION QUESTIONS

1. Why the concept form shareholder to stakeholder changed and what are the benefits of it?
2. “Stakeholder engagement provides opportunities to further align business practices with societal needs and expectations, helping to drive long-term sustainability and shareholder value”. In the context of this, discuss key principles of stakeholder engagement.
3. List out the seven principles of stakeholder management as suggested by Carlson with brief descriptions.
4. What were the recommendations of the Caux Round Table (CRT)?
5. Write short notes on (i) Stakeholder Engagement (ii) Stakeholder Analysis.

CHAPTER 10

GOVERNANCE AND COMPLIANCE RISK

“Governance is the culture, values, mission, structure, layers of policies, processes and measures by which organizations are directed and controlled”.

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| <p>COMPLIANCE RISK</p> | <p>Compliance risk is exposure to legal penalties, financial forfeiture and material loss an organization faces when it fails to act in accordance with industry laws and regulations, internal policies or prescribed best practices. Compliance risk is also sometimes known as integrity risk. This risk is closely interconnected with the operational risk, legal and reputation, so that from one follows the other.</p>  |
| <p>CONSEQUENCES/ RISKS OF NON-COMPLIANCE</p> | <p>Penalties and Fines: Penalties include financial fines, limitations on activities, additional barriers to approval and even imprisonment. Below are a few examples of penalties imposed under the laws and regulations in India.</p> <ul style="list-style-type: none"> ➤ As per section 88 of the Companies Act 2013, if a company fails to maintain a register of members, the company and every officer of the company in default shall be punishable with a fine ranging from 50,000 rupees to 300,000 rupees. Further, as per section 92 of the Act, if a company fails to file a copy of annual return within the prescribed timeline, the company shall be punishable with a fine ranging from 50,000 rupees to 500,000 rupees. ➤ Section 13 of the Foreign Exchange Management Act 1999 imposes a penalty on every person who contravenes any provision of this Act, or contravenes any rule, regulation, notification, direction or order issued in exercise of the powers under this Act, or contravenes any condition subject |

to which an authorisation is issued by the Reserve Bank. The **said penalty can equal up to three times the sum involved in such contravention where the amount is quantifiable, or up to 200,000 rupees where the amount is not quantifiable.** Where such contravention continues, further **penalties can be levied of up to 5,000 rupees** for each day after the first day during which the contravention continues.

- **Section 21 of the Maternity Benefit Act 1961 states** that every employer who does not comply with the provisions of the Act shall be punishable with **imprisonment of up to three months, with a fine of up to 500 rupees or with both.**
- **Section 22A of the Minimum Wages Act 1948** imposes a **penalty** on every employer who contravenes any provision of this Act or any rule or order made thereunder **with a fine of up to 500 rupees.**
- **Additional fee is leviable for Non-filing of Annual RoC forms** as per specified MCA slabs, which may extend upto **12 times of original fees.** Apart from this, provisions for striking off the company and prosecution are also present.

- 1. Criminal Charges:** Criminal charges are a **potential consequence for certain regulatory non-compliance.** Failure to comply in areas pertaining to **staff management, workplace safety, marketing, supply chain, corporate governance, stock management** and due diligence laws could result in jail time for director or board member or other officials.
- 2. Reputational Damage:** A business' public image is a key to its success. When a company is **thrust into the public eye for failing** to comply with regulations, there are reputational repercussions, which eventually lead to distrust. Once that happens, **loyal customers may leave, new customers** may be put off and potentially beneficial partnerships may never develop.
- 3. Access to Markets and Product Delays:** Every country has its own **labor and employment laws, and multinational companies** are obligated to comply with local laws and regulations also. Also businesses are required to meet a host of regulations if they wish to do business with government.

4. Roadblock in Funding: The pre-requisite of any funding exercise is the status of tax and regulatory compliances. A company cannot get funded, even in the seed investment level, whose compliances are not upto date. Banks also require compliance documents like **audited financials, auditor’s report, auditor’s certificate for the last 3 years or as the case may be.** Chances of a non-compliant company availing bank loans are next to zero per cent.

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

| Compliance area (illustrative) | Possible risk of Non-compliance |
|--|---|
| Direct tax compliance | <ul style="list-style-type: none"> ➤ Imposition of penalty Prosecution of directors ➤ Loss of reputation |
| Indirect tax compliance | <ul style="list-style-type: none"> ➤ Cancellation of licences Withdrawal of tax benefits ➤ Stoppage of operations ➤ Loss of reputation |
| Labour law compliance | <ul style="list-style-type: none"> ➤ Imposition of penalty ➤ Prosecution of directors / occupier Loss of reputation ➤ Employee dissatisfaction |
| Environment, health & safety laws | <ul style="list-style-type: none"> ➤ Stoppage of operations ➤ Loss of reputation ➤ Imposition of penalty |
| Corporate law compliance | <ul style="list-style-type: none"> ➤ Imposition of penalty ➤ Vacation / prosecution of directors or management ➤ Loss of reputation |

COMPLIANCE RISK MANAGEMENT

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

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

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| | approach towards compliance management. |
| STEPS IN COMPLIANCE RISK MANAGEMENT | <ol style="list-style-type: none"> <li data-bbox="656 319 1406 674"> 1. Understand compliance obligations : The primary element to manage compliance is to understand compliance obligation in the light of strategic goals and objectives. Compliance obligations stem from: Laws and regulations, industry or generic standards, internal policies, processes and procedures and contracts executed with clients and other stakeholders. for example certain industry standards or best practices – are termed as compliance commitments. <li data-bbox="656 722 1406 993"> 2. Assess risks : Once compliance obligations are established, a compliance risk assessment exercise should be undertaken to identify risks, causes, the areas they impact and the consequences thereof. A risk analysis to have better understanding of the risks should follow. Compliance risks analysed as low should also be monitored and subjected to corrective action. <li data-bbox="656 1041 1406 1396"> 3. Address all compliance risks: An enterprise should ensure an effective action plan to address all compliance risks with clear ownership, responsibility, accountability and closure timelines. This can be driven with ease, if the enterprise ensures a documented compliance policy, objectives, processes and procedures. Further, compliance responsibilities must be clearly identified, assigned and established as part of the job descriptions at different levels. <li data-bbox="656 1444 1406 1845"> 4. Evaluate performance : A mechanism to measure and monitor the performance of the compliance practices and its impact on strategic goals and objectives must be developed. Developing compliance performance indicators is one of the tools. It can be as simple as the number of employees trained on compliance practices to mature indicators such as risks of non-compliance and trends. Feedbacks from clients, stakeholders, suppliers, vendors, employees and government agencies are a good source of data to ascertain compliance performance. |

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| COMPLIANCE RISK MITIGATION | <p>There are a number of critical questions organizations should ask related to compliance risks and the program(s) in place to mitigate those risks:</p> <ul style="list-style-type: none"> ➤ What kinds of compliance failures would create significant brand risk or reputational damage? ➤ Could the failures arise internally, in the supply chain, or with regard to third parties operating on the organization’s behalf? ➤ What is the likely impact of that damage on the organization’s market value, sales, profit, customer loyalty, or ability to operate? ➤ What kinds of compliance missteps could cause the organization to lose the ability to sell or deliver products/services for a period of time? ➤ How should the compliance program design, technology, processes, and resource requirements change in light of growth plans, acquisitions, or product/category/ service expansions? ➤ How well-positioned is the compliance function? Does it have a seat “at the table” in assessing and influencing strategic decisions? ➤ What are the personal and professional exposures of executive management and the board of directors with respect to compliance? |
| <p>The success of any compliance management and monitoring programme depends on the existence, functioning and integration of these lines of defence in the performance of their duties.</p> | |
| 1. Management Assurance | <ul style="list-style-type: none"> ➤ Assists in setting and executing strategies. ➤ Provides direction, guidance and oversight ➤ Promotes a strong risk culture & sustainable risk return thinking ➤ Promotes a strong compliance culture and management of risk exposure. ➤ Ongoing monitoring and management of risks |

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| <p>2. Risk Management, Legal & Compliance</p> | <ul style="list-style-type: none"> ➤ Formal, robust and effective risk management within which the organisation’s policies and minimum standards are set. ➤ Overarching risk oversight across all risk types. ➤ Compile and maintain a legislative universe for the organisation. ➤ Facilitate the risk prioritisation of all pieces of legislation in the regulatory universe. ➤ Initiate new legislative requirements within the organisation. ➤ Facilitate the completion of the Compliance Risk Management Plan (“CRMP”) ➤ Update compliance monitoring plans on the CRMP. ➤ Escalate compliance matters to management. ➤ Undertake quarterly compliance reporting. |
| <p>3. Internal Audit & other Independent Assurance Providers</p> | <ul style="list-style-type: none"> ➤ Independent and objective assurance of overall adequacy and effectiveness of governance, risk management and internal controls within the organization. ➤ Ability to link business risks with established processes and provide assurance on the effectiveness of mitigation plans to effectively manage organisational risks. |
| <p>From their review, Internal Auditors should be able to validate or provide the following inputs to the CRMP:</p> | <ul style="list-style-type: none"> ➤ Impacted Areas – processes, systems and policies ➤ Existing Controls ➤ Additional Controls – arising from amendments to, or new legislation ➤ Risk Exposure – High, Medium, Low ➤ Responsible Party – Affected Parties ➤ Monitoring Plan – Business Unit Compliance |
| <p>ESSENTIALS OF A SUCCESSFUL COMPLIANCE-RISK MANAGEMENT PROGRAM</p> | <ul style="list-style-type: none"> ➤ Active board and senior management oversight ➤ Effective policies and procedures ➤ Compliance risk analysis and comprehensive controls ➤ Effective compliance monitoring and reporting ➤ Testing |
| <p>GOVERNANCE AND RISK COMPLIANCE (GRC)</p> | <p>Until fairly recently, compliance was seen as a separate business practice, along with governance and risk management. However, over the past decade, these three disciplines have developed a considerable number of overlapping activities, such as internal audits, incident management, operational risk assessment, or compliance with regulatory programs. Today, many companies take</p> |

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| | <p>an integrated approach to these three areas, referring to them collectively as Governance, Risk Management and Compliance (GRC).</p> <p>Effective GRC implementation helps the organization to reduce risk and improve control effectiveness, security and compliance through an integrated and unified approach that reduces the ill effects of organizational silos and redundancies.</p> <p>GRC professionals are increasingly being given a seat at the company strategy table, the revenue generating side. Decision-makers need them to interpret risk profiles and data, and provide intelligence on how to increase revenue and sales.</p> |
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SOME EXAMINATION QUESTIONS

1. Define Compliance risk. State briefly the need of compliance risk management in the emerging scenario.
2. Explain the consequences/ risks of non-compliance.
3. What are the steps in effective compliance risk management?
4. How does GRC work ? What are its components?
5. What is the scope and value of GRC for organizational development?
6. Write a short note on essentials of a successful compliance-risk management program.

CHAPTER 11
Corporate Governance Forums

INSTITUTE OF COMPANY SECRETARIES OF INDIA (ICSI)

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| VISION: | “To be a global leader in promoting Good Corporate Governance”. |
| MISSION: | “To develop the high calibre professionals facilitating good Corporate Governance”. |
| ICSI INITIATIVE: | <ol style="list-style-type: none"> 1. <u>Corporate Governance Research and Training</u> - 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. 2. <u>ICSI National Award for Excellence in Corporate Governance</u> -. 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. 3. <u>Focus on Corporate Governance in the Course Curriculum</u> - One full paper on Corporate Governance titled “Governance, Risk Management, Compliances and Ethics” forms part of the syllabus in the Professional Programme. 4. <u>PMQ Course in Corporate Governance</u> - ICSI has launched a Post Membership Qualification Course in Corporate Governance. 5. <u>Secretarial Standards</u> – As a pioneering initiative, ICSI issues Secretarial Standards to integrate, harmonise and standardise the diverse secretarial practices prevalent in the corporate sector. Two Secretarial Standards issued by ICSI i.e. <ul style="list-style-type: none"> • SS-1: Secretarial Standard on Meetings of the Board of Directors and • SS-2: Secretarial Standard on General Meetings have been notified in the Official Gazette under Section 118 (10) of the Companies Act 2013 which provides that every company shall observe Secretarial Standards with respect to General and Board Meetings. 6. <u>Corporate Governance Publications</u> – The Institute regularly brings out publications of interest to members and corporate sector to inculcate the culture of good governance . 7. <u>Investor Education and Awareness</u> – Committed to the cause of investor education, ICSI is actively engaged in activities relating to investor awareness and education. So far, the Institute has organised more than 4500 such programmes. Booklets to educate investors have also been issued by the Institute in English, Hindi as well as other regional languages. |

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| | <p>8. <u>Repository of Independent Directors</u> – The Institute jointly with other professional statutory bodies under the active encouragement of the Ministry of Corporate Affairs, maintains a Repository of Independent Directors to facilitate the individuals who are eligible and willing to act as Independent Directors. who are eligible and willing to act as Independent Directors.</p> <p>9. <u>Customied Training Programme</u> – As an initiative towards propagating and creating awareness on good corporate governance, the Institute has been organising customised training programmes for Regulatory bodies, Banks and Public sector companies on Corporate Laws and Governance.</p> <p>10. <u>Founder member of National Foundation for Corporate Governance</u> – The ICSI is one of the four founder trustees of National Foundation for Corporate Governance, alongwith MCA, CII and ICAI.</p> <p>11. <u>Founder member of Corporate Secretaries International Association (CSIA)</u> – 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.</p> |
| <p>NATIONAL FOUNDATION FOR CORPORATE GOVERNANCE (NFCG)</p> <p>Governing Council</p> <p>Board of</p> | <p>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 the YEAR 2013 along with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI). In the year 2010, stakeholders in NFCG have been expanded with the inclusion of Institute of Cost Accountants of India and the National Stock Exchange of India Ltd.</p> <p>The internal governance structure of NFCG consists:</p> <ul style="list-style-type: none"> ➤ Governing Council ➤ Board of Trustees ➤ Executive Directorate. <p>Governing Council of NFCG works at the apex level for policy making. It is chaired by Minister in- charge, Ministry of Corporate Affairs, Government of India. The members of the Governing Council are :</p> <ul style="list-style-type: none"> ➤ Secretary, Ministry of Corporate Affairs, Government of India -Vice Chairman of the Governing Council; ➤ President, Institute of Chartered Accountants of India (ICAI); ➤ President, Institute of Company Secretaries of India (ICSI); ➤ President , The Institute of Cost Accountants of India (ICAI-CMA); ➤ Secretary, Institute of Chartered Accountants of India (ICAI); ➤ Secretary, Institute of Company Secretaries of India (ICSI); ➤ Secretary, The Institute of Cost Accountants of India (ICAI-CMA); ➤ Chairman, Securities and Exchange Board of India; <p>The members of the Board of Trustees are: -</p> <ul style="list-style-type: none"> ➤ Director General, Confederation of Indian Industry (CII); |

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| <p>Trustees</p> <p>Executive Directorate</p> <p>VISION:</p> <p>MISSION:</p> | <ul style="list-style-type: none"> ➤ Secretary, Institute of Chartered Accountants of India (ICAI); ➤ Secretary, Institute of Company Secretaries of India (ICSI); and ➤ Secretary, The Institute of Cost Accountants of India (ICAI-CMA) ➤ Representative, National Stock Exchange (NSE) <p>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.</p> <p>“Be the Key Facilitator and Reference Point for highest standards of Corporate Governance in India.”</p> <ul style="list-style-type: none"> ➤ To foster a culture for promoting good governance, voluntary compliance and facilitate effective participation of different stakeholders; ➤ To catalyse capacity building in new emerging areas of Corporate Governance. ➤ To further research, scholarship, and education in corporate governance in India; ➤ To create a framework of best practices, structure, processes and ethics; |
| <p>ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD)</p> <p>MISSION:</p> <p>The OECD had focused on:</p> | <p>The Organisation for Economic Co-operation and Development (OECD) was established in 1961 when 18 European countries plus the United States and Canada joined forces to create an organisation dedicated to economic development. It is one of the first non-government organizations to spell out the principles that should govern corporate.</p> <p>The mission of the Organisation for Economic Co-operation and Development (OECD) is to promote policies that will improve the economic and social well-being of people around the world.</p> <p>The OECD had focused on helping governments around the world to:</p> <ul style="list-style-type: none"> ➤ Restore confidence in markets and the institutions that make them function. ➤ Re-establish healthy public finances as a basis for future sustainable economic growth. ➤ Foster and support new sources of growth through innovation, environmentally friendly ‘green growth’ strategies and the development of emerging economies. ➤ Ensure that people of all ages can develop the skills to work productively and satisfyingly in the jobs of tomorrow. |

The OECD provides a forum in which governments can work together to share experiences and seek solutions to common problems. OECD works with governments to **understand what drives economic, social and environmental change**. OECD measures productivity and global flows of **trade and investment** analyse and compare data to predict future trends, set international standards on a wide range of things, from **agriculture and tax to the safety of chemicals** etc.

INSTITUTE OF DIRECTORS (IOD), UK

The IOD is a non party-political business organisation established in United Kingdom in 1903. The IOD is charged with promoting good corporate governance for UK business. The board is composed of the chair, a majority of non-executive directors, and the director general and executive directors. It acts as a unitary board and has the following powers and responsibilities :

- **To manage the affairs and long-term success of the institute**
- **To approve the strategy of the institute, business and financial planning, to hold the executive to account and ensure financial and risk stewardship .**
- **To approve the annual report and accounts**

Objects of IOD

- **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;**
- **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**
- **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.**
- **To advance the interests of members of the Institute, and to provide facilities, services and benefits for them.**

COMMONWEALTH ASSOCIATION OF CORPORATE GOVERNANCE (CACG)

The Commonwealth Association of Corporate Governance (CACG) was established in 1998. The CACG aimed to facilitate the development of institutional capacity that promotes good corporate governance by education, consultation and information in all Commonwealth countries. There are 53 countries of the Commonwealth, of which 46 are currently Commonwealth Foundation members. Membership of the Foundation is voluntary, and is open to all Commonwealth governments.

The CACG had two primary objectives:

- **To promote good standards in corporate governance and business practice throughout the Commonwealth.**
- **To facilitate the development of appropriate institutions which will be able to advance, teach and disseminate such standards.**

The CACG guidelines set out 15 Principles of corporate governance. 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.

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. The Institute of Company Secretaries of India is a member of ICGN and also the country correspondent from India. The ICGN is governed by the ICGN Memorandum and Articles of Association. These principles were first initiated in 1995. The fourth edition of Principles was released in 2014.

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.**

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.

Vision Statement of ECGI:

- Corporate governance lies at the heart of our capitalist systems. It is the interface between capital markets and companies, between employees and executives, and between society and the corporate sector. It is the driver of what companies do, how they do it and the effects they have on others. In other words, it sits at the centre of the success and failure of our economic systems.

Mission Statement of ECGI:

- The mission of ECGI is to assist the top academics in the field of corporate governance in bringing their research to the attention of leading practitioners, policymakers and thought leaders by making state of the art knowledge accessible and relevant to them. It promotes the development of new ideas through research that extends the boundaries of our understanding of how corporate governance contributes to the flourishing of business, economies and societies.

CONFERENCE BOARD

- **The Conference Board was established in 1916 in the United States of America.**
- **The Conference Board creates and disseminates knowledge about management and the marketplace to help businesses strengthen their performance and better servesociety.**
- **The Conference Board is dedicated to equipping theworld’s leading corporations with the practical knowledge they need to improve 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.**

ASIAN CORPORATE GOVERNANCE ASSOCIATION (ACGA)

The Asian Corporate Governance Association (ACGA) is an independent, non-profit membership organization. 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:

- **Research**
- **Advocacy**
- **Education**

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.

CORPORATE SECRETARIES INTERNATIONAL ASSOCIATION (CSIA)

The CSIA an international federation of professional bodies that promotes the best practices in corporate secretarial, corporate governance and compliance services.

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| Strategic Goals: | <ul style="list-style-type: none"> ➤ Reputation ➤ Growth ➤ Advocacy |
| Objectives: | <ul style="list-style-type: none"> ➤ To assist in the creation of such organisations in countries or regions in which they do not currently exist. ➤ To promote the growth, development, study and practice of secretaryship ➤ To promote and recommend uniformity in governance standards. ➤ To promote and actively support good governance |
| Steps to Better Corporate Governance: | <ul style="list-style-type: none"> ➤ Confirm the leadership role of the board chairman . ➤ Check that non-executive directors have the necessary skills, experience, and courage . ➤ Consider the calibre of the non-executive directors . ➤ Review the role and contribution of non-executive directors . ➤ Ensure that all directors have a sound understanding of the company |

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 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**

SOME EXAMINATION QUESTIONS

1. Briefly discuss the initiatives of the Institute of Company Secretaries of India in the area of Corporate Governance.
2. With the goal of promoting better corporate governance practices in India, the Government of India has set up National Foundation for Corporate Governance (NFCG). Explain in brief the mission of NFCG.
3. What is Asian Corporate Governance Association (ACGA) ? Discuss the scope of work of ACGA.
4. Discuss about the Organisation for Economic Co-operation and Development.
5. Write notes on:
 - Commonwealth Association for Corporate Governance
 - Institute of Directors
 - International Corporate Governance Network
 - European Corporate Governance Institute
 - Conference Board
 - Corporate Secretaries International Association

CHAPTER 12
RISK MANAGEMENT

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| Risk | <p>The possibilities of actual outcome being different from the expected outcome.</p> <p>“Risk is Exposure to the possibility of loss, injury, or other adverse or unwelcome circumstance; a chance or situation involving such a possibility”</p> |
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CLASSIFICATION OF RISKS

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

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| <p>Systemic Risk</p> <ul style="list-style-type: none"> ● It is not fully uncontrollable by an organisation. ● It is not entirely predictable. ● It is usually of a macro nature. ● It usually affects a large number of organisations operating under a similar stream. ● It cannot be fully assessed and anticipated in advance in terms of timing and gravity. ● The example of such type of risks is Interest Rate Risk, Market Risk, Purchasing Power Risk. | <p>Unsystemic Risk</p> <ul style="list-style-type: none"> ● It is usually controllable by an organisation. ● It is reasonably predictable. ● It is normally micro in nature. ● If not managed it directly affects the individual organisation first. ● It can be usually assessed well in advance with reasonable efforts and risk mitigation can be planned with proper understanding and risk assessment techniques. ● The examples of such risk are Compliance risk, Credit Risk, Operational Risk. |
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Types of Risks on the basis of impact on finance

The risks may also be broadly segregated as **Financial Risk and Non-financial Risk**. Often both financial and non financial risks are present in any situations which need to be managed and understood.

| <u>Financial Risk</u> | <u>Non-Financial Risk</u> |
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| <p>The risk which has some direct financial impact on the entity is treated as financial risk. This risk may be</p> <ul style="list-style-type: none"> ➤ Market risk, ➤ Credit risk, ➤ Liquidity risk, ➤ Operational Risk, ➤ Legal Risk and ➤ Country Risk. | <p>This type of risks do not usually have direct and immediate financial impact on the business, but the consequences are very serious and later do have significant financial impact if these risks are not controlled at the initial stage. This type of risk may include,</p> <ul style="list-style-type: none"> ➤ Business/Industry & Service Risk, ➤ Strategic Risk, ➤ Compliance Risk, ➤ Industry Fraud Risk, ➤ Reputation Risk, ➤ Transaction risk, ➤ Disaster Risk. |

| Types of Financial Risks | |
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| <p>I. Market Risk</p> | <p>This type of risk is associated with market ups and down. It refers to the risk of loss arising from the change/volatility in the market prices or economic values which are the deciding factors for the pricing of the product/financial assets.</p> <p>The market risks may be Absolute Risk (when it can be measured in rupee/currency term) and Relative Risk (relative to bench mark index). Hence the market risk may be defined as the risk to a firm due to the adverse changes in interest rates, currency rates, equity prices and commodity prices.</p> <ul style="list-style-type: none"> a. Interest Rate Risk: The financial assets which are connected with interest factors such as bonds/ debentures, faces the interest rate risk. For example Interest rate risk adversely affects value of fixed income securities. Any increase in the interest reduces the price of bonds and debts instruments in debt market and vice - versa. So it can be said that the changes in the interest rates have an inverse relationship with the price of bonds. b. Currency Risk: The volatility in the currency rates is called the currency risk. These risks affect the firms which have international |

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| | <p>operations of business and the quantum of the risk depends on the nature and extent of transactions with the external market.</p> <p>c. Equity Risk: It means the depreciation in one's investment due to the change in market index. For example in the context of securities, Beta of a stock tells us the market risk of that stock and it is associated with the day-to-day fluctuations in the market.</p> <p>d. Commodity Risk: This type of risk is associated with the absolute changes in the price of the commodity. Since commodities are physical assets, hence the prices change on account of the demand and supply factor.</p> |
| II. Credit Risk | <p>When a counter party is unable or unwilling to fulfil their contractual obligation, the credit risk arises. This type of risk is related to the probability of default and recovery date. Its effect is measured by cost of replacing cash flow if the other party defaults. For example, in case of loan given by a bank to the borrower and the borrower defaults in making payments of the installments or due interest on the due date, is termed as credit risk.</p> |
| III. Liquidity Risk | <p>The liquidity risk arises due to mis-matches in the cash flow i.e. absence of adequate funds. Liquidity is altogether different from the word solvency. A firm may be in sound position as per the balance sheet, but if the current assets are not in the form of cash or near cash assets, the firm may not make payment to the creditors which adversely affect the reputation of the firm. The liquidity risk may be of two types, trading risk and funding risk.</p> <ul style="list-style-type: none"> ➤ Trading Risk: It may mean the absence of the liquidity or enough products or securities etc to actually undertake buy and sell activities. e.g. in the context of securities trading inability to enter into derivative transactions with counter parties or make sales or purchase of securities. ➤ Funding Risk: It refers to the inability to meet the obligations e.g. inability to manage funds by either borrowing or the sale of assets/securities. It arises where the balance sheet of a firm contains illiquid financial assets which cannot be turned in to cash within a very short time. |
| IV. Operational / System/ Management Risk | <p>It arises due to inadequate systems, system capacities, system failure, and obsolescence risk, management failure on account co-ordination, faulty control or human error. Some best practice against the operational risk includes clear separation of responsibilities with strong internal control and regular contingency planning.</p> |
| V. Obsolescence Risk | <p>In the rapid changing world Obsolescence risk is fast emerging and unless the companies are able to cope up with this timely, the impact will be quite heavy and may lead to closure of the units also. Nokia is the latest example on this.</p> |
| VI. Legal Risk | <p>This risk arises when a counter party does not have the legal or regulatory authority to engage in the transactions. It also includes the compliance and regulatory risk like insider trading, market manipulations, defaults and mismanagement of legal affairs etc.</p> |

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| VII. Political/ Country Risk | <p>Political risk may be on account of declaration of elections in the territory, area specific risk and political uncertainty.</p> <p>The Country risk arises where the firm have its business operations abroad. This risk may arise due to out-break of war between countries, imposition of the ban on the business transaction of particular commodity/product.</p> <p>judiciary, legislative and general environment for business.</p> |
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| Types of Non Financial Risks | |
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| 1. Business/ Industry & Services Risk | Business risks implies uncertainty in profits or danger of loss and the events that could pose a risk due to some unforeseen events in future, which causes business to fail. Business risk refers to the possibility of inadequate profits or even losses due to uncertainties e.g., changes in tastes, preferences of consumers, strikes, increased competition, change in government policy, obsolescence etc. |
| 2. Strategic Risk | Business plans which have not been developed properly and comprehensively since inception may lead to strategic risk. For example, strategic risk might arise from making poor business decisions. |
| 3. Compliance Risk | This risk arises on account of non-compliance or breaches of laws/ regulations which the entity is supposed to adhere. It may result in deterioration of reputation in public eye, penalty and penal provisions. |
| 4. Fraud Risk | Fraud is perpetrated through the abuse of systems, controls, procedures and working practices. It may be perpetrated by an outsider or insider. Fraud may not be usually detected immediately and thus the detection should be planned for on a proactive basis rather than on a reactive basis. |
| 5. Reputation Risk | This type of risk arises from the negative public opinion. Such type of risk may arise from e.g. from the failure to assess and control compliance risk and can result in harm to existing or potential business relationships. |
| 6. Transaction Risk | Transaction risk arises due to the failure or inadequacy of internal system, information channels, employees integrity or operating processes. |
| 7. Disaster Risk | On account of natural calamities like floods, fire, earthquake, man-made risks due to extensive exploitation of land for mines activity, land escalation, risk of failure of disaster management plans formulated by the company etc. |
| 8. Regulatory Risk | On account of change in Government policies and perceptions. Especially this type of risks is associated with Food and beverages and Pharmaceuticals industries. |
| 9. Technology Risk | Failure of system caused due to tampering of data access to critical information, non availability of data and lack of controls. |

RISK MANAGEMENT

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

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

Better risk management techniques provide early warning signals so that the same may be addressed in time. In traditional concept the natural calamities like fire, earthquake, flood, etc were only treated as risk and keeping the safe guard equipments etc were assumed to have mitigated the risk.

Risk management requires commitment from the top management. Thus, **Risk Management Process provides a framework to:**

- **Ensure that all the foreseeable risks involved are actually understood and accepted before important decisions are taken.**
- **Monitor new projects and ongoing operations to ensure that they continue to develop satisfactorily and no problems or new risks emerge.**

Risk Management is part of the corporate strategy. It is a key management tool to safeguard the business assets for its use for the productive purposes. Risk Management is a logical and systematic process of establishing **the context, identifying, analysing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process, in a way that enables an organisation to minimise losses and maximise opportunities.**

ADVANTAGES OF RISK MANAGEMENT

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

- It can **help plan and prepare for the opportunities** that unravel during the course of a project or business.
- Risk Management **improves strategic and business planning**. It reduces costs by limiting legal action or preventing breakages.
- It establishes improved reliability among the **stake holders leading to an enhanced reputation**.
- Sound Risk Management practices reassure key stakeholders throughout the organization.
- Risk Management strongly favours for a focused **INTERNAL AUDIT PROGRAMME**.
- Risk Management in the **long run always results in significant cost savings** and **prevents wastage of time** and effort in firefighting. It develops robust contingency planning.

STEPS IN RISK MANAGEMENT PROCESS



1. RISK IDENTIFICATION

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

By risk identification the organization is able to study the activities and places where its resources are placed to risk. **Correct risk identification ensures effective risk management.**

The results of risk identification are normally documented in a risk register, which includes:

- **A list of identified risks along with their sources,**
- **Potential risk responses and**
- **Risk categories.**

New risks can be identified throughout the project life **cycle as the result of internal or external changes to a project.**

Objective/Purpose:

The objective of the risk identification process is to ensure that all potential project risks are identified. The ultimate purpose **of risk identification is to minimize the negative impact of project hiccups and threats, and to maximize the positive impact of project opportunities.** Awareness of potential project risks reduces the number of surprises during the project delivery and, thus, improves the chances of project success, allowing the team to meet the time, schedule and quality objectives of the project. Finally, the **purpose of risk identification is to provide information for the next step of the risk management process.**

Process of Risk Identification :

An effective risk identification process should include the following steps:

- **Creating a systematic process** - The risk identification process should begin with project objectives and success factors.
- **Gathering information from various sources** - Reliable and high quality information is essential for effective risk management.
- **Applying risk identification tools and techniques** - The choice of the best suitable techniques will depend on the types of risks and activities, as well as organizational maturity.
- **Documenting the risks** - Identified risks should be documented in a risk register and a risk breakdown structure, along with its causes and consequences.

- **Documenting the risk identification process** - To improve and ease the risk identification process for future projects, the approach, participants, and scope of the process should be recorded.
- **Assessing the process' effectiveness** - To improve it for future use, the effectiveness of the chosen process should be critically assessed after the project is completed.

| Seven Identification Essentials | |
|--|---|
| <p>Identification is a process of brainstorming. It isn't an exact science and should involve continuous implementation as new phases, experiences, and viewpoints are introduced. Being vital to the management process, there are some essentials to risk identification that guarantee maximum results.</p> | |
| <p>I.</p> <p>II.</p> <p>III.</p> <p>IV.</p> <p>V.</p> <p>VI.</p> <p>VII.</p> | <p>Team Participation: Face-to-face interactions between project managers and the team promise better and more comprehensive communication. The team must feel comfortable to share and find hidden or elusive risks.</p> <p>Repetition: Information changes appear as the risk management process proceeds. Keeping identified risks current and updated means the system is focused on mitigating the most prevalent issues.</p> <p>Approach: Certain objectives require distinct approaches to best combat identification failure. One method is to identify all root causes, undesirable events and map their potential impacts. Another is to identify essential performance functions the project must enact, then find possible issues with each function or goal. Both methods work well, but the latter may be easier due to its defined scope.</p> <p>Documentation: Consistent and exhaustive documentation leads to comprehensive and reliable solutions for a specific project or future risk management team's analysis. Most communication is recorded by a project manager and data is copied, stored, and updated for continued risk prevention.</p> <p>Roots and Symptoms: It is essential in the risk identification phase to find the root causes of a risk instead of mistaking them with the symptoms. A symptom can be confused with the root cause, making it critical to discover the origin of risks and denote what are their symptoms. Other essentials of risk identification involve the analysis phase. This is where identified risks are further researched and understood.</p> <p>Project Definition Rating Index (PDRI): PDRI is a risk assessment tool that helps develop mitigation programs for high-risk areas. It facilitates the team's risk assessment within the defined project scope, budget and deadlines. It also provides further detail of individual risks and their magnitude, represented by a score. The summation of scores is statistically compared to the project performance as a certainty level for the entire project.</p> <p>Event Trees: Commonly used in reliability studies and probabilistic risk assessments, event trees represent an event followed by all factors and faults related to it. The top of the trees is the event and it is supported by any condition that may lead to that event, helping with likelihood visibility.</p> |

2. RISK ANALYSIS

- After identification of the risk parameters, the second stage is of analyzing the risk which helps to identify and manage potential problems that could undermine key business initiatives or projects.
- **To carry out a Risk Analysis, first identify the possible threats and then estimate the likelihood that these threats will materialize. The analysis should be objective and should be industry specific.**
- Risk Analysis can be **complex, as it requires** to draw on detailed information such as project plans, financial data, security protocols, marketing forecasts and other relevant information. However, **it's an essential planning tool, and one that could save time, money, and reputations.**

Risk analysis is useful in many situations like:

- While planning projects, to **help in anticipating and neutralizing possible problems.**
- While deciding **whether or not to move forward with a project.**
- While improving **safety and managing potential risks in the workplace.**
- While preparing for events such as **equipment or technology failure, theft, staff sickness, or natural disasters.**
- While planning for **changes in environment, such as new competitors coming into the market, or changes to government policy.**
- When all the permutations-combinations of possible events/ threats are listed while analyzing the risk parameters and the steps taken to manage such **risks, the risk matrix is designed / popped-up before the decision making and implementing authority.**

Process of Risk Analysis:

- I. **Identify Threats:** The first step in Risk Analysis is to identify the existing and possible threats that one might face. These can come from many different sources. For instance, they could be:
 - **Human** – Illness, death, injury, or other loss of a key individual.
 - **Operational** – Disruption to supplies and operations, loss of access to essential assets, or failures in distribution.
 - **Reputational** – Loss of customer or employee confidence, or damage to market reputation.
 - **Procedural** – Failures of accountability, internal systems, or controls, or from fraud.
 - **Project** – Going over budget, taking too long on key tasks, or experiencing issues with product or service quality.
 - **Financial** – Business failure, stock market fluctuations, interest rate changes, or non-availability of funding.
 - **Technical** – Advances in technology, or from technical failure. | **Natural** – Weather, natural disasters, or disease.
 - **Political** – Changes in tax, public opinion, government policy, or foreign influence.
 - **Structural** – Dangerous chemicals, poor lighting, falling boxes, or any situation where staff, products, or technology can be harmed.

A number of different approaches can be used to carry out a thorough analysis:

 - Run through a list such as the one above to see if any of these threats are relevant.
 - Think about the systems, processes, or structures used and analyze risks to any part of these.

- Ask others who might have different perspectives. Ask for input from team members and consult others in the organization, or those who run similar projects.
- Tools such as SWOT Analysis and Failure Mode and Effects Analysis can also help to uncover threats, while Scenario Analysis helps to explore possible future threats.

II. **Estimate Risk:** Once the threats are identified, it is required to calculate both the likelihood of these threats being realized, and their possible impact. One way of doing this is to make best estimate of the probability of the event occurring, and then to multiply this by the amount it will cost to set things on the right track. **This gives a value for the risk:**

Risk Value = Probability of Event × Cost of Even

As a simple example, imagine that a risk has been identified that your rent may increase substantially. You think that there's 80 percent chance of this happening within the next year, because your landlord has recently increased rents for other businesses. If this happens, it will cost your business an extra Rs. 500,000 over the next year. So the risk value of the rent increase is:

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

III. RISK ASSESSMENT

Risk assessment is the way in which enterprises get a handle on how significant each risk is to the achievement of their overall goals. The process must proceed in a structured and disciplined fashion. It must be correctly sized to the enterprise's size, complexity, and geographic reach. When assessing risks, it's important to determine whether the risk is - inherent risk, residual risk, or both. Inherent risk as the risk to an entity in the absence of any actions management might take to alter either the risk's likelihood or impact. Residual risk is the risk remaining after management's response to the risk. Some entities interpret:

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

Process of Risk Analysis

1. **Develop assessment criteria:** The first activity within the risk assessment process is to develop a common set of assessment criteria to be deployed across business units, corporate functions, and large capital projects. Risks and opportunities are typically assessed in terms of impact and likelihood.
2. **Assess risks:** Assessing risks consists of assigning values to each risk and opportunity using the defined criteria. An initial screening of the risks and opportunities is performed using qualitative techniques followed by a more quantitative treatment of the most important risks and opportunities lending themselves to quantification (not all risks are meaningfully quantifiable). Qualitative assessment consists of assessing each risk and opportunity according to descriptive scales as described in the previous section. Quantitative analysis requires numerical values for both impact and likelihood using data from a variety of sources.

The quality of the analysis depends on the accuracy and completeness of the numerical values and the validity of the models used. Both qualitative and quantitative techniques have advantages and disadvantages

For qualitative assessments, the most commonly used assessment techniques are interviews, crossfunctional workshops, surveys, benchmarking, and scenario analysis. Quantitative techniques range from benchmarking and scenario analysis to generating forward looking point estimates (deterministic models) and then to generating forward looking distributions (probabilistic models).

3. **Assess risk interactions:** Risks do not exist in isolation. Enterprises have come to recognize the importance of managing risk interactions. Even seemingly insignificant risks on their own have the potential, as they interact with other events and conditions, to cause great damage or create significant opportunity. Therefore, enterprises are gravitating toward an integrated or holistic view of risks using techniques such as risk interaction matrices, bow-tie diagrams, and aggregated probability distributions.
4. **Prioritize risks:** Once the risks have been assessed and their interactions documented, it's time to view the risks as a comprehensive portfolio to enable the next step – prioritizing for risk response and reporting to different stakeholders. Ranking and prioritizing is often done in a two-step process:
 - **First, the risks are ranked according to one, two, or more criteria such as impact rating multiplied by likelihood rating or impact multiplied by vulnerability.**
 - **Second, the ranked risk order is reviewed in light of additional considerations such as impact alone, speed of onset, or the size of the gap between current and desired risk level (risk tolerance threshold). If the initial ranking is done by multiplying financial loss by likelihood, then the final prioritization should take qualitative factors into consideration.**
5. **Response to Risks:** The results of the risk assessment process then serve as the primary input to risk responses whereby response options are examined (accept, reduce, share, or avoid), cost-benefit analyses performed, a response strategy formulated, and risk response plans developed.
6. **Effective and sustainable risk assessment process:** To be effective and sustainable, the risk assessment process needs to be simple, practical, and easy to understand. People aren't enough. To be efficient, they must be supported by the right technology.

IV. HANDLING OF RISK

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

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

2. **Risk Retention/absorption:** It is the handling the unavoidable risk internally and the firm bears/ absorbs it due to the fact that either because insurance cannot be purchased of such type of risk or it may be of too expensive to cover the risk and much more cost-effective to handle the risk internally. There are two types of retention methods for containing losses as under: –
 - **Active Risk Retention: Where the risk is retained as part of deliberate management strategy after conscious evaluation of possible losses and causes. –**
 - **Passive Risk Retention: Where risk retention occurred through negligence. Such type of retaining risk is unknown or because the risk taker either does not know the risk or considers it a lesser risk than it actually is.**
3. **Risk Reduction:** In many ways physical risk reduction (or loss prevention, as it is often called) is the best way of dealing with any risk situation and usually it is possible to take steps to reduce the probability of loss. The ideal time to think of risk reduction measures is at the planning stage of any new project when considerable improvement can be achieved at little or no extra cost. The cautionary note regarding risk reduction is that, as far as possible expenditure should be related to potential future savings in losses and other risk costs; in other words, risk prevention generally should be evaluated in the same way as other investment projects.
4. **Risk Transfer:** This refers to legal assignment of cost of certain potential losses to another. The insurance of ‘risks’ is to occupy an important place, as it deals with those risks that could be transferred to an organization that specialises in accepting them, at a price. Usually, there are 3 major means of loss transfer viz.,
 - **By Tort,**
 - **By contract other than insurance,**
 - **By contract of insurance.**

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

RISK MITIGATION STRATEGY

Risk mitigation is defined as taking steps to reduce adverse effects. Risk mitigation is the process by which an organization introduces specific measures to minimize or eliminate unacceptable risks associated with its operations.

Once risks have been identified and assessed, the strategies to manage the risk fall into one or more of the following categories:

- I. **Transfer Risk:** Normally in projects assignments or multifaceted exercises, execution is fought with risks. Different agencies work together and these agencies take care to transfer risk in their areas to another agency which is better equipped to take care of a

risk for a consideration. The risk may be in the form of loss of reputation or sub quality performance and this risk is taken care of through transfer.

- II. **Tolerate Risk or Risk Retention:** It is retention of the risk. It is accepting the loss when it occurs. True self insurance falls in this category. Risk retention is a viable strategy for small risks where the cost of insuring against the risk would be greater over time than the total losses sustained. All risks that are not avoided, reduced or transferred are retained by default. **War is an example since most property and risks are not insured against war, so the loss attributed by war is retained by the insured.** Also any amount of potential loss (risk) over the amount insured is retained risk. This may also be acceptable if the chance of a very large loss is small or if the cost to insure for greater coverage amounts is so great it would hinder the goals of the organization too much.

- III. **Reduce Risk:** By far the greater number of risks will belong to this category. The purpose of treatment is not necessarily to obviate the risk, but more likely to contain the risk to an acceptable level. Internal controls are actions instigated from within the organization (although their effects may be felt outside of the organization) which are designed to contain risk to acceptable levels. **Outsourcing could be an example** of risk reduction if the outsourcer can demonstrate higher capability at managing or reducing risks. In this case companies outsource only some of their departmental needs. **For example, a company may outsource only its software development, the manufacturing of hard goods, or customer support needs to another company, while handling the business management itself. This way, the company can concentrate more on business development without having to worry as much about the manufacturing process.**

- IV. **Avoid Risk:** This method results in complete elimination of exposure to loss due to a specific risk. It can be established by either avoiding to undertake the risky project or discontinuance of an activity to avoid risk. This means that no risky projects are undertaken. Alternatively, a project may be abandoned midway to mitigate the risk while handling a project. It is not performing an activity which could carry risk. An example would be not buying a property or business in order to not take on the liability that comes with it. Another would be not flying in order to not take the risk that the aeroplanes were to be hijacked. Avoidance may seem the answer to all risks, but avoiding risks also means losing out on the potential gain that accepting (retaining) the risk may have allowed. Not entering a business to avoid the risk of loss also avoids the possibility of earning profits.

- V. **Combine Risk:** When the business faces two or three risks the overall risk is reduced by combination. This strategy is suitable mainly in the areas of financial risk. Different financial instruments say, shares and debentures are taken in a single portfolio to reduce the risk.

- VI. **Sharing Risk: Insurance is a method of sharing risk for a consideration.** For example by paying insurance premium the company shares the risk with companies and the insurance companies themselves share their risk by doing re-insurance.
- VII. **Hedging Risk:** Exposure of funds to fluctuations in foreign exchange rates, prices etc., bring about financial risks resulting in losses or gain. **The downside risk is often taken care.**

MAINTAINING THE RISK STRATEGY

It has already been noted that the risk environment of any organization is constantly changing and developing, and that the priorities of objectives and the consequent importance of risks will shift and change. The risk management process is therefore a dynamic and ongoing one, not an issue for a one off exercise. The process has to allow for periodic review of risks and for consequent adjustment of the control response.

A key tool is the use of **ongoing Control and Risk Self Assessment (CRSA) procedures**. This procedure embeds review of risk and control into the organization at every level and uses the knowledge and experience of the staff that are closest to each function to assess the movement in risks and the appropriateness of control.

FRAUD RISK MANAGEMENT

- **“any behavior by which one person intends to gain a dishonest advantage over another”**. In other words, fraud is an act or omission which is intended to cause wrongful gain to one person and wrongful loss to the other, either by way of concealment of facts or otherwise.
- **Section 25 of the Indian Penal Code, 1860** defines the word, **“Fraudulently”**, which means, a person is said to do a thing fraudulently if he does that thing with intent to defraud but not otherwise.
- **Section 17 of the Indian Contract Act, 1872, ‘fraud’ means and includes** any of the following acts committed by a party to a contract, or with his connivance (intentional active or passive acquiescence), or by his agent with intent to deceive or to induce a person to enter into a contract.
 - The **suggestion that a fact is true** when it is **not true** and the persons making the **suggestion does not believe it to be true**;
 - The active concealment of a fact by a person having knowledge or belief of the fact;
 - A **promise made without any intention of performing it**;
 - Any other act fitted to deceive;
 - Any such act or omission as the law specially declares to be fraudulent.
- **Section 447 of The Companies Act, 2013** defines **“fraud”**, which reads as under:

“fraud” in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or **abuse of position** committed by any person or any other person with the connivance in any manner, **with intent to deceive, to gain undue advantage** from, or to **injure the interests of, the company or its shareholders** or its creditors or any other person, whether or **not there is any wrongful gain or wrongful loss**.

The Fraud Risk Management Policy

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:

1. **Defining fraud:** This shall cover activities which the company would consider as fraudulent.
2. **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.
3. **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.
4. **Disciplinary action:** After due investigations disciplinary action against the fraudster may be considered as per the company’s policy.
5. **Reviewing the policy:** The employees should educate their team members on the importance of complying with Company’s policies & procedures and identifying/ reporting of suspicious activity, where a situation arises. Based on the developments, the policy should be reviewed on periodical basis.

Reporting of fraud under Companies Act 2013

The Companies Act, 2013 has introduced many new reporting requirements for the statutory auditors of companies. One of these requirements is given under the Section 143(12) of the Companies Act, 2013 which requires the statutory auditors or cost accountant or company secretary in practice to report to

the Central Government about the fraud/suspected fraud committed against the company by the officers or employees of the company.

Consequence of non-compliance: Sub-section 15 of section 143 states that if any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12), he shall be punishable with

Minimum fine RS. 100000 Maximum 2500000.

REPUTATION RISK MANAGEMENT

Reputation Risk as the risk arising from negative perception on the part of customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties or regulators that can adversely affect a bank's ability to maintain existing, or establish new, business relationships and continued access to sources of funding (eg through the interbank or securitization markets).

Reputational risk is multidimensional and reflects the perception of other market participants.

Loss of Reputation has long lasting damages like:

- **It destroys the Brand Value**
- **Steep downtrend in share value.**
- **Ruined of Strategic Relationship | Regulatory relationship is damaged which leads to stringent norms.**
- **Recruitment to fetch qualified staff as well the retention of the old employees becomes difficult.**

For managing the reputation risk, the following principles are worth noting:

- Integration of risk while formulating business strategy.
- Effective board oversight. | Image building through effective communication.
- Promoting compliance culture to have good governance.
- Persistently following up the Corporate Values.
- Due care, interaction and feedback from the stakeholders.
- Strong internal checks and controls.
- Peer review and evaluating the company's performance.
- Quality report/ newsletter publications.
- Cultural alignments.

RESPONSIBILITY OF RISK MANAGEMENT

RESPONSIBILITY OF RISK MANAGEMENT:

- I. **Section 134(3) (n) of the Companies Act, 2013** provides that a statement indicating development and implementation of a risk management policy for the company including

identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company.

- II. **SEBI (LODR) Regulations, 2015** also provides that company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.
- III. **The Risk Management Plan must include all elements of risks.** The traditional elements of potential likelihood and potential consequences of an event must be combined with other factors like the timing of the risks, the correlation of the possibility of an event occurring with others, and the confidence in risk estimates.
- IV. 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.
- V. **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.
- VI. **Regulation 21 of SEBI (LODR) Regulations, 2015,**
 - The board of directors shall **constitute a Risk Management Committee.**
 - The **majority of members** of Risk Management Committee shall **consist of members of the board of directors.**
 - The Chairperson of the Risk management committee shall be a member of the board of directors and senior executives of the listed entity may be members of the committee.
 - The risk management committee shall **meet at least once in a year. [Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1-4-2019]**
 - The board of directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem **fit (such function shall specifically cover cyber security).**
 - The provisions of this regulation shall **be applicable to top 500 listed entities,** determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

ROLE OF COMPANY SECRETARY IN RISK MANAGEMENT

The company secretaries are governance professionals whose role is to enforce a compliance framework to safeguard the integrity of the organization and to promote high standards of ethical behavior. He has a significant role in assisting the board of the organization to achieve its

vision and strategy. The activities of the governance professional encompass legal and regulatory duties and obligations and additional responsibilities assigned by the employer. However, in essence, **the functions of a Governance Professional include:**

- **Advising on best practice in governance, risk management and compliance.**
- **Championing the compliance framework to safeguard organizational integrity.**
- **Promoting and acting as a ‘sounding board’ on standards of ethical and corporate behavior.**
- **Balancing the interests of the Board or governing body, management and other stakeholders.**

The listing agreement also provides for the establishment of the Risk Management Committee as per Regulations. Since it is the part of the Corporate Governance norms and non-compliance of the same is to be reported by the Company Secretary.

In terms of Section 203(1)(ii), a Company Secretary is a Key Managerial Person. Hence being a top level officer and board confidante, a Company Secretary can play a role in ensuring that a sound **Enterprise wide Risk Management [ERM]** which is effective throughout the company is in place.

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?**
- Is communication effective — from the top down, across, and from the bottom up the organization?
- **How effective is the process currently in place for exchanging information with external parties?**
- What is the process for assessing the presence and performance quality of all eight ERM components over time?

RISK GOVERNANCE:

Risk governance includes the **skills, infrastructure (i.e., organization structure, controls and information systems), and culture deployed** as directors exercise their oversight. Good risk governance provides clearly defined accountability, authority, and communication/reporting mechanisms.

Risk oversight is the responsibility of the entire Board and the same can be achieved through a review mechanism which inter-alia could include:

- Developing policies and procedures around risk that are consistent with the organization's strategy and risk appetite.
- **Taking steps to foster risk awareness.**
- **Encourage an organizational culture of risk adjusting awareness .**
- **Maintenance of a Risk Register .**
- A compliance certificate on the identification of risks and establishment of mitigation measures.

RISK MANAGEMENT FRAMEWORKS AND STANDARDS

I. Enterprise Risk Management – Integrated Framework (2004)

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

Enterprise risk management encompasses:

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

Components of Enterprise Risk Management:

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

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

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

- **Risk Assessment** – Risks are analyzed, considering likelihood and impact, as a basis for determining how they should be managed. Risks are assessed on an inherent and a residual basis.
- **Risk Response** – Management selects risk responses – avoiding, accepting, reducing, or sharing risk – developing a set of actions to align risks with the entity's risk tolerances and risk appetite.
- **Control Activities** – Policies and procedures are established and implemented to help ensure the risk responses are effectively carried out.
- **Information and Communication** – Relevant information is identified, captured, and communicated in a form and timeframe that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense, flowing down, across, and up the entity.
- **Monitoring** – The entirety of enterprise risk management is monitored and modifications made as necessary. Monitoring is accomplished through ongoing management activities, separate evaluations, or both.

ISO 31000: International Standard for Risk Management

ISO 31000 is the international standard for risk management. This standard is published on the 13th of November 2009.

It is the charter for an effective Risk Management, it provides an uniform set-off principles for adopting Risk Management Process.

Scope

ISO 31000:2009 provides generic guidelines for the design, implementation and maintenance of risk management processes throughout an organization.

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

- Executive level stakeholders.
- Appointment holders in the enterprise risk management group.
- Risk analysts and management officers.
- Line managers and project managers.
- Compliance and internal auditors.
- Independent practitioners.

Benefits:

ISO 31000 ISO 31000 contains 11 key principles that position risk management as a fundamental process in the success of the organization. ISO 31000 is designed to help organizations:

1. **Increase the likelihood of achieving objectives**
2. **Encourage proactive management**
3. **Be aware of the need to identify and treat risk throughout the organization**
4. **Improve the identification of opportunities and threats**
5. **Comply with relevant legal and regulatory requirements and international norms**
6. **Improve financial reporting → Improve governance**
7. **Improve stakeholder confidence and trust**
8. **Establish a reliable basis for decision making and planning**
9. **Improve controls**
10. **Effectively allocate and use resources for risk treatment**
11. **Improve operational effectiveness and efficiency**
12. **Enhance health and safety performance, as well as environmental protection**
13. **Improve loss prevention and incident management**
14. **Minimize losses.**
15. **Improve organizational learning**
16. **Improve organizational resilience.**
17. **Proactively improve operational efficiency and governance.**

Managing risk:

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

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

RISK MANAGEMENT AND INTERNAL CONTROLS

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

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

RISK MATRIX

Risk Matrix is a matrix that is used during Risk & Control Self Assessment (RCSA) activity to define the various levels of risk at each stage, activity, process and sub-process. **Risk Matrix comprises of :**

- **Impact analysis**
- **Likelihood**
- **Operating Effectiveness**
- **Design Effectiveness**

Ratings are assigned to all above categories, pre and post control environment. Based on the ratings a Gross/ Inherent Risk Level and Residual Risk level is determined (**HIGH/MEDIUM/LOW**), respectively. The Inherent and Residual Risks follow the **RED-AMBER-GREEN** color coding mapped to **HIGH-MEDIUM-LOW Risks**, respectively.

MODEL RISK MANAGEMENT POLICY

A risk management policy serves two main purposes: to identify, reduce and prevent undesirable incidents or outcomes and to review past incidents and implement changes to prevent or reduce future incidents. A risk management policy should include the following sections:

- **Risk management and internal control objectives (governance)**
- **Statement of the attitude of the organisation to risk (risk strategy)**
- **Description of the risk aware culture or control environment**
- **Level and nature of risk that is acceptable (risk appetite)**
- **Risk management organisation and arrangements (risk architecture)**
- **Details of procedures for risk recognition and ranking (risk assessment)**

- **List of documentation for analysing and reporting risk (risk protocols)**
- **Risk mitigation requirements and control mechanisms (riskresponse)**
- **Allocation of risk management roles and responsibilities**
- **Risk management training topics and priorities**
- **Criteria for monitoring and benchmarking of risks**
- **Allocation of appropriate resources to risk management**
- **Risk activities and risk priorities for the coming year**

SOME EXAMINATION QUESTIONS

1. What do you mean by Risk Management?
2. Discuss about the Controllable and Un-controllable Risks.
3. Elaborate on different types of Financial and Non-financial Risk.
4. What are the different dimensions of identifying threats in Risk Analysis process ? In a company there is a probability of increase of 40% cost of raw material from present level of Rs 10 crores. What shall be risk value of cost of production ?
5. Describe the Risk Management Process and its advantages?
6. What do you understand by Fraud risk? What strategy can adopt to mitigate such a risk?
7. Whether Risk Management and Corporate Governance Principles have any relations? Explain.
8. Write short notes on:
 - ISO 31000:2009 relating to the Risk Management.
 - Fraud Risk Management.
 - Reputation Risk Management.
 - Reporting of fraud by Statutory Auditor.
 - Risk Matrix.

CHAPTER 13

Compliance Management

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| COMPLIANCE | <p>A compliance management system is the method by which corporate manage the entire compliance process. It includes:</p> <ul style="list-style-type: none"> • The compliance program: consists of the policies and procedures which guide in adherence of laws and regulations. • Compliance audit: The compliance audit is independent testing of level of compliance with various laws and regulations applicable. • Compliance report etc. and in other words it is called compliance solution. • <p>Compliance with law and regulation must be managed as an integral part of any corporate strategy. The board of directors and management must</p> <ul style="list-style-type: none"> ➤ recognize the scope and implications of laws and regulations that apply to the company. ➤ They must establish a compliance management system as a supporting system of risk management system as it reduces compliance risk to a great extent. ➤ To ensure an effective approach to compliance, the participation of senior management in the development and maintenance of a compliance program is necessary. ➤ They should review the effectiveness of its compliance management system at periodic intervals, so as to ensure that it remains updated and relevant in terms of modifications/ changes in regulatory regime including acts, rules, regulations etc. and business environment. | |
| Compliance Vs Conformance: | | |
| BASICS | COMPLIANCE | CONFORMANCE |
| 1. MEANING: | <ul style="list-style-type: none"> ➤ Compliance is forced adherence to a law, regulation, rule, process or practice. | <ul style="list-style-type: none"> ➤ Conformance is voluntary adherence to a standard, rule, specification, requirement, design, process or practice. |
| 2. APPLICABLE: | <ul style="list-style-type: none"> ➤ Compliance applies to laws and regulations that one has no option but to | <ul style="list-style-type: none"> ➤ Conformance applies to strategies and plans that are adopted to be more productive |

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| | <p>follow or face penalties. Such regulations may potentially be productive for society but don't necessarily contribute to an organization's goals.</p> | <p>or to improve quality.</p> |
| <p>SIGNIFICANCE OF COMPLIANCE</p> | <ol style="list-style-type: none"> 1. Image building of a responsible corporate citizen. 2. Stake holders can trust in the working of the corporate. 3. Prevent improper conduct in the organization. 4. It keeps things running smoothly and minimizes risks. 5. It helps the company in maintaining a good reputation 6. Real time status of legal/statutory compliances. 7. Higher Productivity in the Company. 8. Building Positive Reputation. 9. It enhances credibility/creditworthiness being a law abiding company. 10. Proper compliance management avoids the penal provisions. | |
| <p>DIFFERENT ASPECTS OF COMPLIANCES</p> | <p>Regulatory Compliance: Regulatory compliance is an organization's adherence to laws, regulations, guidelines and specifications relevant to its business. Violations of regulatory compliance regulations often result in legal punishment, including penalties/ fines. Regulatory compliance varies not only by industry but often by location. The financial, research, and regulatory structures in one country, for example, may be similar but with particularly different in another country. These similarities and differences are often a product "of reactions to the changing objectives and requirements in different countries, industries, and policy contexts.</p> <p>Corporate Compliance: A corporate compliance program is generally defined as a formal program specifying an organization's policies, procedures, and actions within a process to help prevent and detect violations of laws and regulations. It goes beyond a corporate code-of-conduct since it is an operational program, not simply a code of expected ethical behavior. However, a comprehensive program goes further by applying the code to the specific risks of an organization and integrating measures to address those risks. A corporate compliance program is a magnet that brings all of a company's compliance efforts together. A comprehensive program helps position a company to divert disasters, meet objectives, and grow shareholder value.</p> <p>Legal compliance: Legal compliance is the process or procedure to ensure that an organization follows relevant laws, regulations and business rules. There are two requirements for an enterprise to be compliant with the law, first its policies need to be consistent with the law. Second, its policies need</p> | |

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| | <p>to be complete with respect to the law. It is important to keep in mind that if a strong legal governance component is in place, risk can be accurately assessed and the monitoring of legal compliance be carried out efficiently.</p> <p>Thus legal compliance is a must and if the company has entered into formal contracts with customers, the clauses of those contracts also become legal requirements. Without adherence to the letter of the law, the corporates face costly litigation and the potential of untold damage to the business and its reputation</p> |
| <p>CORPORATE COMPLIANCE MANAGEMENT</p> | <p>Corporate compliance management involves a full process of research and analysis as well as investigation and evaluation. The goals of compliance, a compliance program, sometimes called a corporate compliance program or regulatory compliance program, include:</p> <ul style="list-style-type: none"> ➤ Compliance with legal and regulatory requirements. ➤ Compliance with internal policies and contracts. ➤ Management of related compliance risks. ➤ Establishment of an ethical culture |
| <p>SIGNIFICANCE OF CORPORATE COMPLIANCE MANAGEMENT</p> | <ol style="list-style-type: none"> 1. Image building of a responsible corporate citizen. 2. Stake holders can trust in the working of the corporate. 3. Prevent improper conduct in the organization. 4. It keeps things running smoothly and minimizes risks. 5. It helps the company in maintaining a good reputation. 6. Real time status of legal/statutory Prevent unintended non compliances/ prosecutions. 7. Higher Productivity in the Company. 8. Building Positive Reputation |
| <p>ESSENTIALS OF AN EFFECTIVE COMPLIANCE PROGRAM</p> | <p>A corporate compliance program is generally defined as a formal program specifying an organization’s policies, procedures, and actions within a process to help prevent and detect violations of laws and regulations. The essential of a successful compliance program may be list out as under:</p> <ol style="list-style-type: none"> 1. Development of written Compliance Policies, Procedures and framing of Standards: The successful implementation of any compliance program needs a well drafted written document of the compliance policy. Until and unless one have a written policy, how the deviation from the set standard will be measured. Further it is also important that the compliance policies and procedures should be designed in such a way that it helps employees remain in compliance while carrying out their job functions. 2. Designation of a compliance officer and compliance committee: A designated compliance officer, who shall take care of the regulatory compliance related functions and he shall be responsible to ensure to have the adherence of the compliance policy and put up |

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| | <p>a note before the Board of Directors periodically for their perusal and directions wherever required.</p> <ol style="list-style-type: none"> 3. Developing open lines of communication: The Compliance Policy shall have a provision to welcome open communication for reporting instances of potential fraud and abuse. This concept of whistle blower may prove to be early warning signals and may be effective in prevention thereof. The name and designation of the reporting official shall be kept confidential. 4. Appropriate training and education: For effective implementation of the compliance policy and for updating employees, officers, there is need of proper training and education. 5. Internal monitoring and auditing: The compliance policy shall contain a clause for having the effective auditing and monitoring plans. 6. Response to detected deficiencies: Wherever the deficiencies in the prescribed procedure come in the knowledge of the concerned official, there shall be a reporting system to make a report to the designated official. 7. Enforcement of disciplinary standards: There shall be a clause in the compliance policy to take the disciplinary action against the erring official, who has not adhered to the prescribed set of rules and regulations. <p>Effective use of Information technology: By using available tools of information technology compliances can be managed effectively. Various compliance management software are available to facilitate compliance management.</p> |
| <p>CHALLENGES FOR EFFECTIVE CORPORATE COMPLIANCE MANAGEMENT</p> | <ol style="list-style-type: none"> 1. Large number of legislations and multiple regulators. 2. Multiple business locations attracting state legislations. 3. lack of ownership /awareness of functional staff about compliance requirements. 4. Segmented compliance initiatives. 5. Time-consuming and unreliable manual reporting. 6. Dynamic legal environment, lack of a robust updation process, frequent changes in process owners and internal processes. |
| <p>PROCESS OF CORPORATE COMPLIANCE MANAGEMENT</p> | <p>Installing proper compliance process is a must for the success of compliance programme. Systematic approach helps in chalking out a plan of action in right direction. Some companies have a streamlined, highly efficient system for managing their compliance requirements. By adopting a unified approach to regulatory management, companies can minimize costs, maximize efficiency and reduce their risk exposure. It is desirable that the compliance management process is so designed that it is able to generate a complete MIS Report for secretarial and legal data providing the key information including company details, key dates, brief information about company's</p> |

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| | <p>business, certifications obtained, addresses of office locations, details of Board of Directors, shareholding pattern, key registration nos. such as company registration no., scrip code, ISIN code etc., contact details of agencies such as auditors, consultant, banker, government agencies, printers, R&T agents etc It is essential to segregate roles and responsibilities within the function to ensure proper distribution of work, rotation of responsibilities where possible, avoid confusion and set focus for each person within the function. Critical compliance means the severity of compliance and its impact on business, while it is true that all laws are of equal importance and should be complied with in letter and spirit.</p> |
| <p>CHECKLIST TO BE FOLLOWED FOR SETTING UP A GOOD COMPLIANCE PROGRAM</p> | <ul style="list-style-type: none"> a. Understand the Scope: Identify all regulatory and internal compliance needs and efforts to challenge if organizational responsibilities are properly aligned. This should not be a “one and done” step, but rather performed periodically as regulatory landscapes and operational environments are typically changing. b. Gather Internal and External Intelligence: Tap the collective intelligence of the company by soliciting thoughts from the Board, management and employees. Also look beyond the walls of the organization to understand industry developments and competitor reactions to corporate compliance. This includes researching legal actions to help identify risks. c. Define Objectives: Define objectives from an enterprise and business unit standpoints. d. Conduct a Risk Assessment: Identify risks, probabilities, and the significance in terms of both qualitative and quantitative measures. Consider scenarios from a cause-and-effect . e. StandpointAlign Controls: Policies, procedures, and actions within a process, should be in place to address the risks to best achieve objectives. f. Verify /Buy-In and Understandability: Everyone needs to know their roles. For control owners to be expected to act appropriately, they need to understand the “why” and “how” of the compliance program. Controls need to be clearly communicated, ideally with a feedback loop so control owners can voice their insights and concerns. g. Test Cultural Support: Many organizations have put in place paper programs that have no real effect on the operations of the organization. Determine if the cultures at headquarters and all relevant business units are supportive of a strong corporate compliance program. This can be accomplished through surveys, independent reviews and entity-level control assessments. h. Assess On-Going Compliance: Build monitoring, internal audit and special reviews into the compliance program to help ensure that controls are operating effectively. This effort should also seek to |

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| | <p>identify the most-efficient alignment of responsibilities and controls.</p> <ul style="list-style-type: none"> i. Train, Educate and Communicate: Deliver periodic targeted training and share compliance information with the business units, global functions, external partners, customers, vendors, and other stakeholder groups. j. Measure Results and Report to Board: Develop a reporting dashboard to keep management groups and the Board aware of compliance measures, trends and developments. This should address both internal and external activities. |
| <p>INTERNAL COMPLIANCE REPORTING MECHANISM (ICRM)</p> | <p>The Internal Compliance Reporting Mechanism (ICRM) should be sound and fool proof. Deviations in nonreporting should be avoided. In any Compliance Program it is of paramount important that the employees working in the organisation shall feel free in reporting non-compliance related issues either by their own parts or has observed any deficiency on the counter part. The ICRM may involve the following process:</p> <ul style="list-style-type: none"> ➤ Establish a robust reporting mechanism. ➤ Encourage employees to report the non-compliance in a fear less environment. ➤ Functional Heads be made responsible to collect such information in a time bound manner. ➤ Early warning signals should be identified of the possible areas of the non-compliances. ➤ <p>A sound program should include the following elements:</p> <ul style="list-style-type: none"> • Communication : make the program known to all levels of employees. • Accessibility : make the program available to all employees around the world in various languages. • Cultural Appropriateness : adapt the program to the constraints imposed by local culture, history and practice. • Universality : make the reporting mechanism available to relevant third parties, e.g. suppliers, consultants, customers. • Confidentiality and Anonymity : guarantee confidentiality and permit discreet or anonymous reports. • Screening : provide safeguards against frivolous or malicious reports. • Collect Data: monitor reports, track them over time, identify vulnerabilities and take corrective action. • Remedial Action and Feedback: take action and provide feedback to the reporter as appropriate. |

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| | <ul style="list-style-type: none"> • Management Visibility: report to the audit committee or board of directors. • Employee Protection: protect reporting employees both during employment and after departure from the company. • External Communication: report to shareholders and other interested parties on actions taken and results achieved. |
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| SCOPE OF CORPORATE COMPLIANCE MANAGEMENT | |
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| Corporate & Economic Laws : | <ul style="list-style-type: none"> ➤ Companies Act, 1956 and the various Rules and Regulations framed there under, MCA-21 requirements and procedures. ➤ Secretarial Standards/Accounting Standards/Cost Accounting Standards issued by ICSI/ICAI/ ICAI(Cost) respectively. ➤ Emblems and Names (Prevention of Improper Use) Act, 1947. ➤ Foreign Exchange Management Act, 1999 and the various Notifications, Rules and Regulations framed there under. ➤ Foreign Contribution Regulation Act, 1976. ➤ Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974. ➤ Competition Law. – Special Economic Zones Act, 2005. – Prevention of Money Laundering Act, 2002. |
| Securities Laws: | <ul style="list-style-type: none"> ➤ SEBI Act, 1992 . ➤ Securities (Contracts) Regulation Act, 1956 and rules made thereunder. ➤ Various rules, regulations guidelines and circulars issued by SEBI. ➤ Provisions of SEBI (Listing Obligations and Disclosure requirements) Regulations, 2015. ➤ Sarbanes-Oxley Act, 2002 and other legislations etc, wherever applicable. ➤ Depositories Act, 1996. |
| Commercial Laws: | <ul style="list-style-type: none"> ➤ Indian Contract Act, 1872. ➤ Negotiable Instruments Act, 1881. ➤ Sale of Goods Act, 1930. |
| Fiscal Laws: | <ul style="list-style-type: none"> ➤ Income Tax Act, 1961. ➤ Central Excise Act, 1944. ➤ Customs Act, 1962 . ➤ Service Tax. |
| Labour Laws: | <ul style="list-style-type: none"> ➤ Minimum Wages Act, 1948. ➤ Payment of Bonus Act, 1965. ➤ Payment of Gratuity Act, 1972. ➤ Factories Act, 1948. |

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| | ➤ Industrial Dispute Act, 1947. |
| Pollution/Environment related Laws: | <ul style="list-style-type: none"> ➤ Air (Prevention and Control of Pollution) Act, 1981. ➤ Water (Prevention and Control of Pollution) Act, 1974. ➤ Environment Protection Act, 1986. ➤ Public Liability Insurance Act, 1991. |
| Industry Specific Laws: | ➤ Legislations applicable to specific categories of industries – electricity, power generation and transmission, insurance, banking, chit funds, etc. |

| USE OF TECHNOLOGY FOR COMPLIANCE MANAGEMENT | |
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| A well-designed compliance management programme has abilities to perform the following key functions across the enterprise: [CARPET] | |
| Compliance Dashboard: | The compliance programme must provide a single enterprise-wide dashboard for all users to track and trend compliance events. All compliance events should be easily viewed interactively through the enterprise compliance dashboard. External auditors, internal auditors, compliance officers can use the dashboards to make decisions on the compliance status of the organization. |
| Policy and Procedure Management: | A well-designed document management system forms the basis of managing the entire lifecycle of policies and procedures within an enterprise. |
| Event Management: | The compliance management system must have ability to capture and track events, cases and incidents across the extended enterprise. Compliance officers, call centre personnel, IT departments, QA personnel, ethics hotline should be able to log in any adverse event across the enterprise, upon which the necessary corrective and preventive actions are initiated. |
| Rules and Regulations: | A well-designed compliance management solution must offer capabilities for organization to continuously stay in sync with changing rules and regulations. As soon as there are regulatory changes, the various departments should be notified proactively through “email based” collaboration. A well-designed Compliance management programme offers up-to-date regulatory alerts across the enterprise. |
| Audit Management: | Audits have now become part of the enterprise core infrastructure. Internal audits, financial audits, external audits, vendor audits must be facilitated through a real-time system. Audits are no more an annual activity and corporations offer appropriate audit capabilities. Appropriate evidence of internal audits becomes critical in defending compliance to regulations. |
| Quality Management: | Most organizations have internal operational, plant-level or departmental quality initiatives to industry mandates like Six-sigma or ISO 9000. |
| Training Management: | Most compliance programs often require evidence of employee training. Sarbanes-Oxley Act, stress on employee training. Well-designed compliance program requires a well-integrated approach to training management. |
| Compliance Task Management: | Organizations must plan, manage and report status of all compliance related activities from a centralized solution. Automated updates from the various compliance modules should provide for up-to-the-minute status |

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| | reporting that could be viewed by the Board, corporate compliance officer, entity compliance coordinators, quality offices and others as designated. |
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| COMPLIANCE SOLUTIONS | |
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| Risk/Cultural Assessment: | Through employee surveys, interviews, and document reviews, a company's culture of ethics and compliance at all levels of the organization is validated. Our Reports and recommendations with detail observations identify gaps between company's current practices and benchmarks with international practices. |
| Program Design/Update: | In this phase, compliance solution providers help company in creating guideline documents that outline the reporting structure, communications methods, and other key components of the code of ethics and compliance program. |
| Policies and Procedures: | In this phase compliance solution providers help company to develop or enhance the detailed policies of the program, including issues of financial reporting, antitrust, conflicts of interest, gifts and entertainment, records accuracy and retention, employment, the environment, global business, fraud, political activities, securities, and sexual harassment, among others. |
| Communication, Training and Implementation: | Compliance solution providers help company to clearly articulate, communicate, and reinforce not only the specifics of the program, but also the philosophy behind it, and the day-to-day realities of it. In this way, key stakeholders and other personnel are more likely to embrace the program and incorporate it into their attitudes and behaviours. |
| Ongoing self-Assessment, Monitoring and Reporting: | The true test of a company's ethics and compliance program comes over time. The cultural assessment, mechanisms, and processes put in place including employee surveys, internal controls, and monitoring and auditing programs, help organisations achieve sustained success. |

| ROLE OF COMPANY SECRETARIES |
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| <p>Company Secretaries with core competence in compliance and corporate governance play a crucial role in the corporate compliance management. Corporate Compliance Management can add substantial business value only if compliance is done with due diligence. A Company Secretary is the 'Compliance Manager' of the company.</p> <p>It is he who ensures that the company is in total compliance with all regulatory provisions. Also as per section 204(1) of Companies Act, 2013 read with rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, Company Secretary in Practice is the secretarial auditor. In terms of Form MR-3 the secretarial auditor needs to examine and report on the compliance of the following five specific laws:</p> <ul style="list-style-type: none"> ● The Companies Act, 2013 (the Act) and the rules made thereunder. ● The Securities Contracts (Regulation) Act, 1956 ("SCRA") and the rules made hereunder. ● The Depositories Act, 1996 and the Regulations and Bye laws framed thereunder. ● Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder to |

the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings.

- **The following Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992 („SEBI Act“):-**
 - The Securities and Exchange Board of India (**Substantial Acquisition of Shares and Takeovers) Regulations, 2011;**
 - The Securities and Exchange Board of India (**Prohibition of Insider Trading) Regulations, 1992.**
 - The Securities and Exchange Board of India (**Issue of Capital and Disclosure Requirements) Regulations, 2009.**
 - The Securities and Exchange Board of India (**Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.**
 - The Securities and Exchange Board of India (**Issue and Listing of Debt Securities) Regulations, 2008.**

SOME EXAMINATION QUESTIONS

1. Draft a Compliance Management programme for a listed company.
2. Difference between compliance and Conformance.
3. Describe the scope of compliance management.
4. Explain compliance management process in general.
5. Explain the systems approach to compliance management.
6. "A corporate compliance program is a formal program specifying an organization's policies, procedures and actions within a process to help prevent and detect violations of laws and regulations". In this context discuss the essential of an effective compliance program.

CHAPTER 14

Internal Control

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| INTERNAL CONTROL: | <p>The International Standard on Auditing 315 (SA 315) defines internal control. According to SA 315:</p> <p>Internal control is a process designed, implemented and maintained by those charged with the governance, management and other personnel.[TCWG]</p> <p>It provides reasonable assurance about the</p> <ul style="list-style-type: none"> • achievement of an entity’s objectives in the categories of financial reporting, • effectiveness and efficiency of operations, • safeguarding of assets and • compliance with applicable laws and regulations.[LOAF] |
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| CLASSIFICATION OF INTERNAL CONTROL | |
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| <p>Internal control can broadly be classified into two categories viz.:</p> <ul style="list-style-type: none"> ➤ Accounting controls/financial controls, and ➤ Administrative controls. | |
| Accounting controls/financial controls: | <p>Accounting controls comprise the plan of organisation and all methods and procedures that are concerned mainly with and relate to, the safeguarding of assets and the reliability of the financial information. Internal control relating to accounting system aims at ensuring that: –</p> <ul style="list-style-type: none"> ➤ The transactions are executed in accordance with the management’s authorization. ➤ All transactions are promptly recorded in an appropriate manner to permit the preparation of financial information and to maintain accountability for assets. ➤ The access to assets is permitted only in accordance with the management authorization. ➤ The assets are reviewed and verified at reasonable intervals and appropriate action is taken with regard to the variances. <p>It can safely be said that scope of internal control is much wider than that of accounting controls.</p> <p>Example: maintaining inventory is an accounting control.</p> |
| Administrative Controls: | <p>A number of controls falling under operational controls can also be administrative controls. Administrative controls are</p> |

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| | <p>very wide in their scope. They include all other managerial controls concerned with decision making process. They are concerned with the authorisation of transactions and include anything from plan of organisation to procedures, record keeping, distribution of authority and the process of decision-making. Administrative controls have an indirect relationship with financial records and the auditor may evaluate only those administrative controls which have a bearing on the financial records.</p> <p>Examples of operational controls are: quality control, works standards, periodic reporting, policy appraisal etc.</p> |
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| ELEMENTS OF INTERNAL CONTROL: | |
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| Segregation of duties: | The division of an operation into a series of sub-operations undertaken by different people, allows for internal checks to take place. Such a control merely reduces the chance of error or irregularity occurring , but it does not eliminate the risk . It reduces the risk of intentional manipulation and error and increases the element of checking . |
| Organisational structure: | The structure or pattern of an organisation will mean system of arrangements and relations as between various levels of personnel for carrying out of plans and policies towards achievement of objectives for which the business stands. The delegation of authority and responsibility should be clearly specified. A common cause of irregularity is imbalance between responsibility, status and remuneration. |
| Authorisation and approval: | All transactions should require authorisation or approval by an appropriate responsible person . While designing procedures, provision should be made for proper authorization, to establish full accountability for the actions taken. |
| Personnel: | There should be procedures to ensure that personnel have capabilities commensurate with their responsibilities . The qualifications, selection and training as well as the innate personal characteristics of the personnel involved are important features to be considered in setting up any control system . |
| Management: | Management is responsible for establishing, monitoring and reviewing the systems of internal control. In practice, management may delegate the reviewing function to internal auditor. It is, thus the duty of internal auditor to provide management with reassurance concerning the efficiency and effectiveness of internal controls. |
| Accounting Controls: | These are the controls within the recording function which |

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| | <p>check that the transactions to be recorded and processed have been authorised, and that they are all included and that they are correctly recorded and accurately processed. Such controls include checking the arithmetical accuracy of the records, the maintenance and checking of totals, reconciliations, control accounts and trial balances, and accounting for documents.</p> |
| <p>Supervision:</p> | <p>Any system of internal control should include the supervision by responsible officials of day-to-day transactions and the recording thereof. The supervisory role undertaken by staff should be allocated to those with proper training and suitability to such a function.</p> |
| <p>COMPONENTS OF INTERNAL CONTROL (MICRA)</p> | |
| <p>Control Environment: The control environment is the comprehensive set of actions taken by management that set the tone for how employees engage in their day-to-day activities. The control environment is comprised of all policies and procedures the actions taken by management to deal with issues, and the values they espouse. Taken as a whole, the control environment shows the level of support that management has for the system of internal controls. If control environment is weak then internal control tends to be weak.</p> <p>The control environment encompasses the following elements:</p> <ol style="list-style-type: none"> a. Communication and enforcement of integrity and ethical values . b. Commitment to competence. c. Participation by those charged with governance. d. Management’s philosophy and operating style. e. Organizational structure. f. Assignment of authority and responsibility. g. Human resource policies and practices. | |
| <p>Entity’s Risk Assessment Process: For financial reporting purposes, the entity’s risk assessment process includes how management identifies business risks relevant to the preparation of financial statements in accordance with the entity’s applicable financial reporting framework, estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to respond to and manage them and the results thereof. Risks can arise or change due to circumstances such as the following:</p> <ul style="list-style-type: none"> ● Changes in operating environment. ● New personnel. ● Rapid growth. ● New technology. ● New business models, products, or activities. ● Corporate restructurings. | |
| <p>Information System, Including the Related Business Processes, Relevant to Financial Reporting, and Communication:</p> <p>The information system relevant to financial reporting objectives, which includes the financial reporting system, encompasses methods and records that:</p> <ul style="list-style-type: none"> ● Identify and record all valid transactions. ● Describe on a timely basis the transactions in sufficient detail to permit proper classification | |

of transactions for financial reporting.

- Measure the **value of transactions** in a manner that permits recording their **proper monetary value in the financial statements**.
- Determine the time **period in which transactions occurred** to permit recording of transactions in the **proper accounting period**.
- Present properly the **transactions and related disclosures in the financial statements**.

Communication, which involves providing an **understanding of individual roles and responsibilities pertaining to internal control over financial reporting**, may take such forms as policy manuals, accounting and financial reporting manuals, and memoranda. Communication also can be made **electronically, orally, and through the actions of management**.

Control Activities: Generally, control activities that may be relevant to an audit may be categorized as policies and procedures that pertain to the following:

- **Performance reviews:** These control activities **include reviews and analyses of actual performance** versus budgets, forecasts, and prior period performance; relating different sets of data – **operating or financial – to one another, together with analyses of the relationships and investigative and corrective actions**; comparing internal data with external sources of information; and review of functional or activity performance.
- **Information processing:** The two broad groupings of information systems control activities are application controls, which apply to the processing of **individual applications, and general IT controls**, which are policies and procedures that relate to many applications and support the effective functioning of application controls by **helping to ensure the continued proper operation of information systems**.
- **Monitoring of Controls:** An important management responsibility is to establish and maintain internal control on an on-going basis. Monitoring of controls may include activities such as management's review of whether bank reconciliations are being prepared on a timely basis, internal auditors' evaluation of sales personnel's compliance with the entity's policies on terms of sales contracts, and a legal department's oversight of compliance with the entity's ethical or business practice policies. Monitoring is done also to ensure that controls continue to operate effectively over time.
- **Physical controls:** Controls that encompass:
 - **The physical security of assets**, including **adequate safeguards** such as secured facilities over **access to assets and records**.
 - The authorization **for access to computer programs and data files**.
 - The periodic counting and comparison with amounts shown on control records (for example, comparing the **results of cash, security and inventory counts with accounting records**).

LIMITATIONS OF INTERNAL CONTROL

1. Internal control **may reduce the auditors vigilance** and observations with an **unfavourable effect on the quality of audit**.
2. Internal control is expensive to **install and maintain**.
3. The management may over rely on the **strength of internal control system** and relax their supervision which may leave room for **errors and frauds thus** exposing the auditor to potential **civil liabilities**.

4. If not well instituted it may encourage over staffing.
5. Rigid implementation may lead to a **slowdown in the operation.**
6. Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control.
7. Further, in **designing and implementing controls**, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the **risks it chooses to assume.**

TECHNIQUES OF INTERNAL CONTROL SYSTEM

Any business that hires employees runs the risk of fraudulent activity. Fraud can have a large negative impact on one's business's bottom line. The following points in this regard are worth mentioned:

- There should be **clear division of the work.**
- **Segregation of the work** should be in such a manner that the work done by one person is the beginning of the work for another person.
- There should be the clarity **of the responsibility.**
- The **work flow process be documented** or standardized so that the staff may perform the work as suggested in the work flow chart.
- **No single persons should be allowed to have access or control over any important business operation.**
- There should be **job rotation** of the staff duties periodically.
- Staff should be asked to go on mandatory **leave periodically** so that other person may come to know if someone is playing foul with the system.

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| Internal Check | <p>The Institute of Chartered Accountants of England and Wales defines internal check as the allocation of authority and work in such a manner as to effort the checks on the day to day transactions which operate continuously as part of routine system whereby the work of one person is automatically proved independently or is complementary to the work of another, the object being prevention or early detection of error and frauds.</p> <p>The following are the important objects of internal check system: (i) To assign to a specific person, the responsibility of particular acts, defaults or omissions by allocation of specific duties. (ii) To obtain physical and financial confirmation of facts and entries physical and financial by creation and preservation of necessary records. (iii) To facilitate the breakdown of accounting procedures where required so as to avoid bottlenecks and establish an even flow of work and operations. (iv) To reduce the possibilities of fraud and errors.</p> <p>Essential Features of Internal Check:</p> <ul style="list-style-type: none"> ➤ There should be proper division of work and responsibilities. ➤ The duties of each person should be properly defined so as to fix definite responsibilities of each individual. ➤ Possibilities of giving absolute control to anybody should not be left out unchecked. ➤ Too much confidence on a person should be avoided. ➤ Physical inventory of fixed assets and stocks should be taken periodically. ➤ Assets should be protected from unauthorised use. |
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| Internal Audit | <p>“Internal audit is an independent appraisal activity established within an organisation to examine and evaluate the activities as a service to the organisation. The objective of internal audit is to assist members of the organisation in the effective discharge of their responsibilities. To this end, the internal auditor furnishes them with analyses, appraisal, recommendations, counsel and information concerning the activities reviewed.”</p> <p>The following are the main aspects of internal auditing: 1. Review, appraisal and evaluation of the soundness, adequacy and application of financial, accounting and other operating controls. 2. Ascertaining the adequacy and reliability of management information and control systems. 3. Ascertaining the achievement of management objectives and compliance with established plans, policies and procedures. 4. Ensuring proper safeguards for assets - their utilization and accounting thereof. 5. Detection and prevention of fraud and error. 6. Ascertaining the integrity of management data in an organisation.</p> <p>Risk based Internal Audit (RBIA) is an internal methodology which is primarily focused on the inherent risk involved in the activities or system and provide assurance that risk is being managed by the management within the defined risk appetite level It is the risk management framework of the management and seeks at every stage to reinforce the responsibility of management and BOD (Board of Directors) for managing risk.</p> |
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| STEPS FOR INTERNAL CONTROL | |
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| <ul style="list-style-type: none"> ➤ Identify the key areas where the internal control mechanism is to be established. ➤ Every work flow should be so documented that it is not complete if another person has not checked it out. ➤ The other person’s role should start when the first person’s role comes to an end. ➤ Establish the surprise check mechanism where the money matters are involved. ➤ Reporting of the non-adherence of key compliance areas. ➤ Review mechanism of the control units. ➤ Establishment of Vigil Mechanism. | |

| COSO’S INTERNAL CONTROL FRAMEWORK |
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The Committee of Sponsoring Organizations of the Treadway Commission (COSO). It is a joint initiative of the five private sector organizations (American Accounting Association, American Institute of CPA, Financial Executives International, The Association of Accountants and Financial Professionals in Business and The Institute of Internal Auditors) and is dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management, internal control and fraud deterrence.

In 1992 the COSO released its Internal Control–Integrated Framework (the original framework). On May 14, 2013, COSO released its revisions and updates to the 1992 document Internal Control .

As per **definition given by COSO**, the Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to **operations, reporting, and compliance**.

The fundamental concepts from the definition of Internal Control are:

- **Geared to the achievement of objectives** in one or more separate but overlapping Categories.
- A process **consisting of ongoing tasks and activities** – it is a means to an end, not an end in itself.
- **Effected by people** – it is not merely about policy and procedure manuals, systems, and forms, but about people and the actions they take at every level of an organization to effect internal control.
- **Able to provide reasonable assurance**, not absolute assurance, to an entity's senior management and board of directors.
- **Adaptable to the entity structure** – flexible in application for the entire entity or for a particular subsidiary, division, operating unit, or business process.

Objectives:

The Framework sets forth three categories of objectives, which allow organizations to focus on separate aspects of internal control:

- **Operations Objectives:** These pertain to effectiveness and efficiency of the entity's operations, **including operational and financial performance goals, and safeguarding assets against loss.**
- **Reporting Objectives :** These pertain to internal and external financial and non-financial reporting and may encompass reliability, **timeliness, transparency, or other terms as set forth by regulators, standard setters, or the entity's policies.**
- **Compliance Objectives:** These pertain to **adherence to laws and regulations** to which the entity is subject.

Components of Internal Control: When we talk about the Internal Control, two key phrase comes to our mind i.e.

1. **Internal check and**
2. **Internal audit.**

1. **Internal Check :** Internal check means an arrangement that a transaction is **process by two or more persons and each one is independent and starts** with when the predecessor has completed the task. So, it is a self balancing system, which have the in-built systems of independent checking of the work done by other.
2. **Internal Audit :** The second important aspect is the internal audit. Internal audit may be done by the own staff or by engaging any professional person outside of the organisation. The scope of the internal audit is determined by the management. Internal Auditor is required to submit its report to the management (who is appointing authority). The report should inter alia cover the points relating to the, adequacy of the internal check and control systems, adherence to the established management controls, maintenance of the records and reports on the financial accounting etc. The internal audit should be carried out of all the Departments of the organisations and before start of the audit, the auditor should well understand the plans,

policies and procedures of the Dept/Firm in order to find the job specifications, its descriptions and accountability.

Relationship of Objectives and Control:

A direct relationship exists between objectives, which are what an entity strives to achieve, components, which represent what is required to achieve the objectives, and entity structure (the operating units, legal entities, and other structures).



COSO's Internal Control - Integrated Framework

The relationship can be depicted in the form of a cube.

- The **three categories of objectives** are represented by the columns.
- **The five components** are represented by the rows.
- The entity structure, which represents the overall entity, divisions, subsidiaries, operating units, or functions, including business processes such as sales, purchasing, production, and marketing and to which internal control relates, are depicted by the third dimension of the cube.

Efficacy of Internal Controls and its Review

The efficacy of the internal control mechanism depends when the employees accept this philosophy in the true letter and spirit.

Q. What Internal Control Can Do:

- Internal control can help an entity achieve its performance and profitability targets, and prevent loss of resources.
- It can help ensure **reliable financial reporting**.
- It can help ensure that the enterprise complies with laws and regulations, **avoiding damage** to its **reputation and other consequences**.
- In sum, it can **help an entity get to where it wants to go**, and avoid pitfalls and **surprises along the way**.

Limitation of Internal control

Limitation of Internal control:

- Internal control **cannot change an inherently poor manager** into a good one.
- Internal control cannot ensure success, or even survival in case of shifts in government policy or programs, competitors' actions or economic conditions, since these are beyond the management's control.
- An internal control system, no matter how well conceived and operated, can provide only reasonable-- **not absolute--assurance** to management and the board regarding achievement of an entity's objectives.
- The likelihood of achievement is affected by **limitations inherent in all internal control systems.**
- Controls can be circumvented by the collusion of **two or more people, and management has the ability to override the system.**
- Another limiting factor is that the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.
- Thus, while internal control **can help an entity achieve its objectives, it is not a panacea.**

ROLE AND RESPONSIBILITIES WITH REGARD TO INTERNAL CONTROL

Everyone in an organization has responsibility for internal control.

Management: The **chief executive officer** is ultimately responsible and should assume **"ownership"** of the system. More than any other individual, the chief executive sets the **"tone at the top"** that affects integrity and ethics and other factors of a positive control environment.

SEBI (LODR) Regulations, 2015

The **CEO or the Managing Director or manager or in their absence, a Whole Time Director appointed in terms of Companies Act, 2013 and the CFO shall certify to the Board that :**

- A.** They have **reviewed financial statements and the cash flow statement** for the year and that to the best of their knowledge and belief :
 - these statements **do not contain any materially untrue statement** or omit any material fact or contain statements that might be misleading;
 - 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:

- **significant changes in internal control over financial reporting during the year;**
- **significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and**
- **instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting.**

Board of Directors: Management is accountable to the board of directors, which provides governance, guidance and oversight. Effective board members are objective, capable and inquisitive. They also have a knowledge of the entity's activities and environment, and commit the time necessary to fulfill their board responsibilities. A strong, active board, particularly when coupled with effective upward communications channels and capable financial, legal and internal audit functions, is often best able to identify and correct such a problem.

Companies Act 2013 Section 134(5)(e) The Directors' Responsibility Statement referred shall state that:

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

Internal Auditors: Internal auditors play an **important role in evaluating the effectiveness of control systems**, and contribute to ongoing effectiveness. Because of organizational position and authority in an entity, an internal audit function often **plays a significant monitoring role**.

Other Personnel: Internal control is, to some degree, the responsibility of everyone in an organization and therefore should be an explicit or implicit part of everyone's job description. Virtually all employees produce information used in the internal control system or take other actions needed.

SOME EXAMINATION QUESTIONSS

1. Discuss in brief the components and principles of Internal Control.
2. Discuss briefly the efficacy of Internal Control.
3. Discuss in detail about the COSO's Internal Control Framework.
4. Write a note on the roles and responsibilities of Internal Control System.
5. Internal check and internal control are two frequently used terms in risk management and compliance. Explain the meaning of Internal Check and Internal Control and also mention how these two are different from each other

CHAPTER 15
Reporting

| FINANCIAL REPORTING | |
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| MEANING: | Financial reporting is the process of producing statements that disclose an organisation's financial status to management, investors and the government. |
| PURPOSES: | <ul style="list-style-type: none"> • It helps management to engage in effective decision making concerning the company's objectives and overall strategies. • Financial reporting provides vital information about the financial health and activities of the company to its stakeholders including its shareholders, potential investors, consumers, and government regulators. |
| COMPONENTS: | <ul style="list-style-type: none"> • The financial statements – Balance Sheet, Statement of Profit & Loss, Cash flow statement & Statement of changes in stockholder's equity. • The notes to financial statements . • Quarterly & Annual reports (in case of listed companies) . • Prospectus (In case of companies going for IPOs). • Management Discussion & Analysis (In case of public companies) |
| OBJECTIVES: | <ol style="list-style-type: none"> 1) Helps management of an organisation in planning, analysis, benchmarking and decision making. 2) Helps investors, promoters, debt provider, creditors in making rational and prudent decisions regarding investment, credit etc. 3) Providing information to shareholders & public at large in case of listed companies about various aspects of an organisation. 4) Providing information as to how an organisation is procuring & using various resources. 5) Providing information to the statutory auditors which in turn facilitates audit.. |
| IMPORTANCE: | <ul style="list-style-type: none"> ➤ In helps and organisation to comply with various statues and regulatory requirements applicable to company. ➤ Financial Reports forms backbone for financial planning, analysis, bench marking and decision making. These are used for above purposes by various stakeholders. ➤ Financial reporting helps organisations to raise capital both domestic as well as overseas. ➤ On the basis of financials, the public in large can analyze the performance of the Organization as well as of its management. |
| LIMITATIONS: | <ul style="list-style-type: none"> ➤ Information provided by financial reporting are approximate rather than exact measures. ➤ Financial reporting are historical in nature. |

- **Involve huge cost.**

NON-FINANCIAL REPORTING:

It contains the information relating to the **company's performance during the previous year, future projections, award achievements and penalty imposed**, if any by any regulators, are apprised to the Stake holders by way of reporting in the annual report.

Non-financial reporting is an **opportunity to communicate in an open and transparent way with stakeholders**. In their non-financial reports, firms volunteer an overview of their environmental and social impact during the previous year. **The information in nonfinancial reports contributes to building up a company's risk-return profile.**

BOARD'S REPORT:

The Companies Act, 2013, requires the Board of Directors of every company to attach its report to the financial statements to be laid **before the members at the annual general meeting**. The Board's Report is an important means of communication, provides the stakeholders with both financial and non-financial information. **A board's report should typically include information under following heads:**

- **Company Specific Information**
- **General Information**
- **Corporate Social Responsibility (CSR)**
- **Risk Management**
- **Auditors Report**
- **Secretarial Audit Report**
- **Explanations in Response to Auditors' Qualifications**
- **Compliance With Secretarial Standards**
- **Corporate Insolvency Resolution Process Initiated Under The Insolvency And Bankruptcy Code, 2016 (IBC)**
- **Annual Return**
- **Failure to Implement any Corporate Action.**

CORPORATE SOCIAL RESPONSIBILITY REPORT:

The Board of the Company is mandated to prepare a CSR Report under **Section 134(3)(o) of the Companies Act, 2013. The Companies (CSR Policy) Rules, 2014** provide for the format for reporting CSR activities annually. The format for the **annual report on CSR activities** to be included in the Board's report is as follows:

- **The Composition of the CSR Committee.**
- **Average net profit of the company for the last three financial years**
- **Prescribed CSR expenditure (two per cent,)**
- **Details of CSR spent during the financial year**
- **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.**
- **Total amount to be spent for the financial year:**
- **Amount unspent, if any.**

CORPORATE SUSTAINABILITY REPORTING:

Corporate sustainability is an approach that **creates long-term stakeholder value** by implementing a business strategy that **considers every dimension of how a business operates** in the **ethical, social, environmental, cultural, and economic** spheres.

A sustainability report is an organizational report that gives information about economic, environmental, social and governance performance. **Sustainability reporting aims to communicate an organization’s sustainability priorities, policies, programs and performance to its investors.**

Sustainability reporting can be considered as synonymous with other terms for non-financial reporting; **triple bottom line reporting, corporate social responsibility (CSR) reporting**, and more. It is also an intrinsic element of integrated reporting; a more recent development that combines the analysis of financial and non-financial performance.

BENEFITS:

- 1. Internal benefits of sustainability reporting** for companies and organizations can include:
 - **Increased understanding of risks and opportunities.**
 - **Emphasizing the link between financial and non-financial performance .**
 - **Influencing long term management strategy and policy, and business plans.**
 - **Streamlining processes, reducing costs and improving efficiency.**
 - **Avoiding being implicated in publicized environmental, social and governance failures**
- 2. External benefits of sustainability reporting** can include:
 - **Mitigating – or reversing – negative environmental, social and governance impacts**
 - **Improving reputation** and brand loyalty
 - Enabling **external stakeholders to understand the organization’s true value**, and tangible and intangible assets
 - Demonstrating how the organization influences, and is influenced by, **expectations about sustainable development**

CHALLENGES IN MAINSTREAMING SUSTAINABILITY REPORTING**Government Encouragement:**

In many jurisdictions, there are no guidelines on sustainability reporting to encourage the corporate sector. 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.

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 organizing such awareness programme** jointly with the experts in the field of Sustainability Reporting.

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.

Investor Behaviour:

It is a recognized principle that investors should consider the **Environmental, Social and Governance (ESG) issues while making investment decisions.**

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| | 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. |
| KEY DRIVERS | |
| Regulations: | Governments, at most levels 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 . |
| Employees: | Those who work for a company bring particular pressure to bear on how their employers behave; they, too, are concerned citizens beyond their corporate roles . |
| Investors: | Increasingly, investors want to know that companies they have targeted have responsible, sustainable, long-term business approaches . |
| 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. |

GLOBAL REPORTING INITIATIVE - SUSTAINABILITY REPORTING FRAMEWORK

As for financial reporting, companies follow a generally accepted reporting framework; Global Reporting Initiative (GRI) has developed a generally accepted framework to simplify report preparation and assessment, helping both reporters and report users gain **greater value from sustainability reporting**.

The aim of the Guidelines is to assist reporting organizations and their stakeholders in articulating and understanding contributions of the reporting organizations **to sustainable development**.

The GRI Sustainability Reporting Framework is **made up of the Sustainability Reporting Guidelines, Sector supplements and Indicator Protocols**. Together these are known as the Sustainability Reporting Framework.

Sustainability Reporting Guidelines:

The Sustainability Reporting Guidelines are the core element of the Reporting Framework. They outline content that is broadly relevant to all organizations regardless of size, sector or location. The Sustainability Reporting Guidelines developed by the Global Reporting Initiative, is a significant system that integrates sustainability issues in to a frame of reporting.

G4 is applicable to all organizations, large and small, across the world. The Guidelines are now presented in two parts to facilitate the identification of reporting requirements and related guidance. It consist of following two parts

- **Part 1- Reporting Principles and Standard Disclosures:** It contains the reporting principles and standard disclosures and also sets out the criteria to be applied by an organization to prepare its sustainability report in accordance with the Guidelines.
- **Part 2 - Implementation Manual:** It contains reporting and interpretative guidance that an organization should consult when preparing its sustainability report.

SUSTAINABILITY REPORTING FRAMEWORK IN INDIA

Considering the importance of sustainability in businesses, **MCA launched Corporate Social Responsibility Voluntary Guidelines in 2009. This voluntary CSR Policy addresses six core elements – Care for all Stakeholders, Ethical functioning, Respect for Workers’ Rights and Welfare, Respect for Human Rights, Respect for Environment and Activities for Social and Inclusive Development.** To take this further, in 2011 MCA issued ‘**National Voluntary Guidelines on Social, Environmental and Economical Responsibilities of Business**’ which encourages reporting on environment, social and governance issues.

National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business and considering the larger interest of public disclosure regarding steps taken by listed entities from a **Environmental, Social and Governance (“ESG”) perspective, SEBI decided to mandate inclusion of Business Responsibility Reports (“BRR reports”)** as part of the **Annual Reports for listed entities.**

SEBI in its (Listing Obligations and Disclosure Requirements) Regulations, 2015 has mandated the requirement of submission of **BRR for top 500 listed entities** describing initiative taken by them from an environmental, social and governance perspective in the prescribed format [**Regulation 34(2)(f)**].

The BRR framework is divided into five sections:

- **Section A: General Information about the Organisation** – Industry Sector, Products & Services, Markets, other general information
- **Section B: Financial Details of the Organisation** – Paid up capital, Turnover, Profits, CSR (Corporate Social Responsibility) spend.
- **Section C: Other Details – BR initiatives** at Subsidiaries and Supply-chain Partners
- **Section D: BR Information** – Structure, Governance & Policies for Business Responsibility
- **Section E: Principle-wise Performance** – Indicators to assess performance on the 9 Business Responsibility principles as envisaged by the National Voluntary Guidelines (NVGs).

1. Section A: General Information about the Company:

- Corporate Identity Number (CIN) of the Company
- Name of the Company 3. Registered address
- **Website**
- **E-mail id**
- **Financial Year reported.**

2. Section B: Financial Details of the Company:

- Paid up Capital (INR)
- **Total Turnover (INR)**
- **Total profit after taxes (INR)**
- Total Spending on Corporate Social Responsibility (CSR) as percentage of profit after tax (%).

3. Section C: Other Details:

- **Does the Company have any Subsidiary Company/ Companies?**
- **Do the Subsidiary Company/Companies participate in the BR Initiatives of the parent company? If yes, then indicate the number of such subsidiary company(s)**
- Do any other entity/entities (e.g. suppliers, distributors etc.) that the Company does business with, participate in the BR initiatives of the Company? If yes, then indicate the percentage of such entity/ entities? [Less than 30%, 30-60%, More than 60%].

4. Section D: BR Information:

- Details of Director/Directors responsible for BR
 - Details of the Director/Director responsible for implementation of the BR policy/policies
 - **DIN Number**
 - **Name**
 - **Designation**
- **Details of the BR head.**

5. Section E: Principle-wise performance:

Principle 1:

- Does the policy relating to ethics, bribery and corruption cover only the company? Yes/ No. Does it extend to the Group/Joint Ventures/ Suppliers/Contractors/NGOs/Others?
- **How many stakeholder complaints have been received in the past financial year** and what percentage was satisfactorily resolved by the management? If so, provide details thereof, in about 50 words or so.

Principle 2:

- **List up to 3 of your products or services whose design** has incorporated social or environmental concerns, risks and/or opportunities.
 - .
 - .
 - .
- Does the company have procedures in place for sustainable sourcing (including transportation)? If yes, what percentage of your inputs was sourced sustainably? Also, provide details thereof, in about 50 words or so.

Principle 3:

- **Please indicate the Total number of employees.**
- **Please indicate the Total number of employees hired on temporary/contractual/casual basis.**
- **Please indicate the Number of permanent women employees.**
- Please indicate the Number of permanent employees with disabilities.
- Do you have an employee association that is recognized by management.

Principle 4:

- **Has the company mapped its internal and external stakeholders? Yes/No**
- Out of the above, has the company identified the disadvantaged, vulnerable & marginalized stakeholders.
- Are there any **special initiatives taken by the company** to engage with the disadvantaged, vulnerable and marginalized stakeholders. If so, provide details thereof, in about 50 words or so.

Principle 5:

- Does the policy of the company on **human rights cover only the company or extend to the Group/Joint Ventures/Suppliers/Contractors/NGOs/Others?**
- How many stakeholder complaints have been received in the past financial year and what percent was satisfactorily resolved by the management?

Principle 6:

- Does the policy related to Principle 6 cover only the company or extends to the Group/Joint Ventures/ Suppliers/Contractors/NGOs/others.
- **Does the company have strategies/ initiatives to address global environmental issues such as climate change, global warming, etc? Y/N. If yes, please give hyperlink for webpage etc.**
- Does the company identify and assess potential environmental risks? Y/N
- Does the company have any project related to Clean Development Mechanism? If so, provide details thereof, in about 50 words or so. Also, if Yes, whether any environmental compliance report is filed?
- Has the company undertaken any other initiatives on – clean technology, energy efficiency, renewable energy, etc. Y/N. If yes, please give hyperlink for web page etc.
- Are the Emissions/Waste generated by the company within the permissible limits given by CPCB/SPCB for the financial year being reported?
- **Number of show cause/ legal notices received from CPCB/SPCB which are pending (i.e. not resolved to satisfaction) as on end of Financial Year.**

Principle 7:

- **Is your company a member of any trade and chamber or association? If Yes, Name only those major ones that your business deals with:**
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- Have you advocated/lobbied through above associations for the advancement or improvement of public good? Yes/No; if yes specify the broad areas (drop box: Governance and Administration, Economic Reforms, Inclusive Development Policies, Energy security, Water, Food Security, Sustainable Business Principles, Others)

Principle 8:

- **Does the company have specified programmes/initiatives/projects** in pursuit of the policy related to Principle 8? If yes details thereof.
- Are the programmes/projects undertaken through in-house team/own foundation/external NGO/ government structures/any other organization?
- Have you done any impact assessment of your initiative?
- **What is your company's direct contribution to community** development projects- Amount in INR and the details of the projects undertaken.

Principle 9:

- **What percentage of customer complaints/consumer cases are pending as on the end of financial year.**
- Does the company display product information on the product label, over and above what is mandated as per local laws? Yes/No/N.A. /Remarks(additional information)
- Is there any case filed by any stakeholder against the company regarding unfair trade practices, irresponsible advertising and/or anti-competitive behaviour during the last five years and pending as on end of financial year. If so, provide details thereof, in about 50 words or so.
- **Did your company carry out any consumer survey/ consumer satisfaction trends?**

National Guidelines on Responsible Business Conduct (NGRBC)

The Ministry of Corporate Affairs has revised the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 (NVGs) and has released the National Guidelines on Responsible Business Conduct (NGRBC) in March 2019. These guidelines urge businesses to actualise the principles in letter and spirit. This annexure 3 of the Guidelines details the reporting framework associated with the National Guidelines for Responsible Business Conduct. **It consists of three sections:**

- **Section A – General Disclosures**, covering operational, financial and ownership related information,
- **Section B – Management and Process Disclosures** covering the structures, policies and processes to integrate the Guidelines, and
- **Section C – Principle-wise Performance** Indicators covering how well businesses are performing in pursuit of these Guidelines.

CHALLENGES IN MAINSTREAMING SUSTAINABILITY REPORTING

Since the Sustainability Reporting is relatively a new concept, many organizations find it difficult to prepare sustainability. Following may be considered as the challenges in mainstreaming sustainability reporting:

- 1. Government Encouragement:** In many jurisdictions, there are no guidelines on sustainability reporting to encourage the corporate sector. While on the other hand, there are voluntary as well as mandatory guidelines from regulators for reporting on Sustainability aspects like in India we have SEBI framework of Business Responsibility Report. In South Africa, listed companies are required to prepare Integrated Report which is one step ahead of sustainability reporting. It is the need of the hour that governments should encourage the corporate in their jurisdiction to adopt the sustainability reporting as a measure of good corporate governance.
- 2. Awareness:** lack of awareness about the emerging concept of sustainability reporting is also a major challenge which the government and corporate governance bodies need to address by arranging the sustainability awareness programme for the Professionals, Board of Directors and Management in the corporate sector, as these are the persons who will drive sustainability reporting initiative for an organisation. The government/regulators should organize such awareness programme jointly with the experts in the field of Sustainability Reporting.
- 3. Expertise Knowledge:** Sustainability Reporting is relatively a new concept in many jurisdictions and organization found it very difficult to prepare a sustainability report in the absence of expert guidance on the subject. The Sustainability Reporting concept is emerging as a good tool to showcase the corporate governance practices of an organisation and this area demand professionals having expert knowledge of sustainability reporting. The professional bodies in various jurisdictions should impart the expert knowledge of sustainability reporting to their members to develop a good cadre of experts in this emerging area of sustainability reporting.
- 4. Investor Behaviour:** It is a recognized principle that investors should consider the Environmental, Social and Governance (ESG) issues while making investment decisions. There are specific regulators guidelines for the institutional investor to be vigilant on voting aspects and be concerned about the governance practices of the companies in which they invest. However, the investor behaviour may vary from company to company and sometimes they invest in companies without considering the ESG issues either due to lack of awareness on ESG issues or some other business reasons. It should be made a practice that the investor fund flow to those organization following the good governance including reporting on sustainability aspects.

INTEGRATED REPORTING

MEANING:

The **International Integrated Reporting Council (IIRC)** defines integrated reporting as “a process that results in communication by an organisation, most visibly a periodic **integrated report**, about how an organisation’s strategy, governance, performance, and prospects lead to the creation of value over the **short, medium and long-term.**”

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| PURPOSE: | The primary purpose of an integrated report is to explain to providers of financial capital how an organisation creates value over time. An integrated report benefits all stakeholders interested in an organisation's ability to create value over time, including employees, customers, suppliers, business partners, local communities, legislators, regulators and policy-makers. |
| FRAMEWORK: | <ul style="list-style-type: none"> ➤ Identifies information to be included in an integrated report for use in assessing the organization's ability to create value; it does not set benchmarks for such things as the quality of an organization's strategy or the level of its performance . ➤ Is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations. |
| Guiding Principles: | <ul style="list-style-type: none"> ➤ Strategic focus and future orientation ➤ Connectivity of information ➤ Stakeholder relationships ➤ Materiality ➤ An integrated report should be concise. ➤ Consistency and comparability. |
| Integrated Reporting by Listed Entities in India | |

Also **regulation 4(1)(d) of SEBI LODR states "the listed entity shall provide adequate and timely information to recognised stock exchange(s) and investors"**. IOSCO Principle 16 states "there should be full, accurate and timely disclosure of financial results, risks and other information that is material to investors' decisions."

The purpose of integrated reporting is to provide shareholders and interested stakeholders with relevant information that is useful for making investment decisions.

All organizations depend on various forms of capital for their success. It is important that all such forms of capital are disclosed to stakeholders to enable informed investment decision making. IIRC has **categorized the forms of capital as follows:**

- **Financial capital**
- **Manufactured capital**
- **Intellectual capital**
- **Human capital**
- **Social and relationship capital**
- **Natural capital**

It has been observed that certain listed entities in India and other jurisdictions have already been making disclosures by following the principles of integrated reporting. Towards the objective of improving disclosure standards, in consultation with industry bodies and stock exchanges, the listed entities have been advised to adhere to the following by the SEBI vide this circular:

- Integrated Reporting may be adopted on a voluntary basis from the financial year 2017-18 **by top 500 companies which are required to prepare BRR.**
- The information related to Integrated Reporting may be **provided in the annual report** separately or by incorporating in Management Discussion & Analysis or by preparing a separate report (**annual report prepared as per IR framework**).
- In case the company has already provided the relevant information in any other report **prepared in accordance with national/international requirement / framework**, it may provide appropriate reference to the same in its Integrated Report so as to avoid duplication of information.
- As a **green initiative**, the companies may host the **Integrated Report on their website** and provide appropriate reference to the same in their Annual Report.

RELATION BETWEEN INTEGRATED REPORTING AND SUSTAINABILITY REPORTING

Sustainability reporting is a process that assists organizations in setting goals, measuring performance and managing change towards a sustainable global economy – **one that combines long term profitability with social responsibility and environmental care. Sustainability reporting – mainly through but not limited to a sustainability report** – is the key platform for communicating the organization’s **economic, environmental, social and governance performance**, reflecting **positive and negative impacts**. The Aspects that the organization deems to be material, in response to its stakeholders’ expectations and interests, drive sustainability reporting. Stakeholders can include those who are invested in the organization as well as those who have other relationships with the organization.

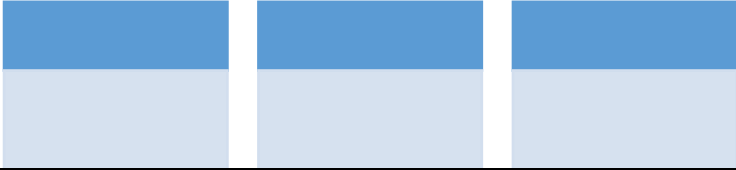
Integrated reporting is an emerging and evolving trend in corporate reporting, which in general aims primarily to offer an **organization’s providers of financial capital with an integrated representation of the key factors that are material to its present and future value creation**. Integrated reporters build on sustainability reporting foundations and disclosures in preparing their integrated report. Through the integrated report, an organization provides a concise communication **about how its strategy, governance, performance and prospects lead to the creation of value over time**. Therefore, the integrated report is not intended to be an extract of the traditional annual report nor a combination of the annual financial statements and the sustainability report. However, the **integrated report interacts with other reports and communications by making reference to additional detailed information that is provided separately**.

Although the objectives of sustainability reporting and integrated reporting may be different, sustainability reporting is an intrinsic element of integrated reporting. Sustainability reporting considers the relevance of sustainability to an **organization and also addresses sustainability priorities and key topics, focusing on the impact of sustainability trends, risks and opportunities on the long term prospects and financial performance of the organization. Sustainability reporting is fundamental** to an organization’s integrated thinking and reporting process in providing input into the organization’s identification of its material issues, its strategic objectives, and the assessment of its ability to achieve those **objectives and create value over time**.

SOME EXAMINATION QUESTIONSS

1. What is Integrated Reporting?
2. Apart from the Financial Reporting, Non-financial reporting has become an integral part of the Annual Report. Please elucidate.
3. Discuss the limitations of financial reporting .
4. What is a Sustainability Report?
5. Discuss the integrated reporting by listed entities in India.

CHAPTER 16
Ethics and Business

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| ETHICS | As per the Oxford Dictionary the meaning of ethics is a “system of moral principles, rules and conduct.” Ethics is a “Science of morals.” The word ethics has emerged from Latin ‘Ethicus’ or in Greek ‘Ethicos’ . The origin of these two words is from ‘ethos’ meaning character. |
| MEANING | 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. |
| BUSSINESS ETHICS | <p>Business ethics constitute the ethical/moral principles and challenges that arise in a business environment. Business Ethics is the application of ethical principles and methods of analysis to business.</p> <div style="display: flex; justify-content: space-around; margin-top: 20px;"> <ul style="list-style-type: none"> • Creative accounting • Insider trading <ul style="list-style-type: none"> • Whistle blowing • Union busting <ul style="list-style-type: none"> • Price fixing • Green washing </div> <div style="text-align: center; margin-top: 20px;">  </div> |
| FIVE BOTTOM LINES OF FUTURE | |

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| <p>Economic Bottomline:</p> | <p>Wealth-creation is the most basic and fundamental dharma of business. A business organization which doesn't create wealth for the society is adharmic, unethical. We have to focus more on the causative factors which lead to these economic goals like for example: Technology, Productivity, Quality, Customer, Service, Innovation or "knowledge". These are the key-factors of the Economic Bottomline.</p> |
| <p>Human Bottomline:</p> | <p>The Key Result Areas in this domain are those factors which lead to a better quality of the work-force like for example: Leadership, Teamwork, Motivation, Creativity, Ethics, Values and Wellness.</p> |
| <p>Social Bottomline:</p> | <p>An organization is an integral part of the larger social environment. In the long-term, wellbeing of the organization depends on the wellbeing of the society. This is the rationale behind the concept of Corporate Social Responsibility (CSR) which is gaining increasing acceptance among corporate leaders. However, here also the concept and practice of CSR has to progress beyond isolated charitable projects to embrace the community as a whole.</p> |
| <p>Environmental Bottomline:</p> | <p>We are not only part of society but also part of Nature. Any human group which draws energy and resources from Nature has a responsibility to use them prudently within the laws and limits set by Nature. Here again as with CSR, the highest aim of ecological responsibility is to harmonize the communal life of the group (especially the economic and material life) and the resource-energy management strategies, with the laws of Nature and the natural environment.</p> |
| <p>Evolutionary Bottomline:</p> | <p>We humans, as a species, are an unfinished project. We have not yet realized all our potentialities hidden within us, especially in the moral, psychological and spiritual realms of our consciousness. We have to progress or evolve further to reach our highest potential as human being. The work and life of the modern corporate world provides a rich field of experience not only for professional growth but also for evolution of the individual. The problems, difficulties, challenges, temptation and conflicts of the corporate world, are a fertile arena for becoming fully conscious of our weaknesses and strengths and also for expressing our inner potentialities.</p> |
| <p>ORGANISATION STRUCTURE AND ETHICS</p> | |
| <p>centralized organization:</p> | <p>Decision making authority is concentrated in the hands of top-level managers, and very little authority is delegated to the lower levels. 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. Centralized organizations stress on formal rules, policies, and procedures, backed up by elaborate control systems.</p> |

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| <p>Decentralized organization:</p> | <p>Decision-making authority is delegated as far down the chain of command as possible. Such organizations have relatively few formal rules, coordination and control are usually informal and personal. They focus on increasing the flow of information. As a result, one of the main strengths of decentralized organizations is their adaptability and early recognition of external change. This provides greater flexibility to managers and they can react quickly to changes in their ethical environment. Weakness of decentralized organizations lies in the fact that they have difficulty in responding quickly to changes in policy and procedures established by the top management. In addition, independent profit centers within a decentralized organization may sometimes deviate from organizational objectives.</p> |
| <p>Organisational issues related to ethics:</p> | <ul style="list-style-type: none"> • The alienation experienced by workers doing repetitive work. • Health problems created by unsafe working condition. • The feelings of oppression created by the exercise of authority . • The responsibilities heaped on the shoulders of managers. |
| <p>Four fundamental ethical principles</p> | |
| <p>1. The Principle of Respect for autonomy :</p> <p>2. The Principle of Beneficence:</p> <p>3. The Principle of nonmaleficence:</p> <p>4. The Principle of justice:</p> | <p>Autonomy is Latin for “self-rule” We have an obligation to respect the autonomy of other persons, which is to respect the decisions made by other people concerning their own lives. This is also called the principle of human dignity. Corollary principles: honesty in our dealings with others & obligation to keep promises.</p> <p>We have an obligation to bring about good in all our actions. Corollary principle :We must take positive steps to prevent harm.</p> <p>We have an obligation not to harm others: “First, do no harm. Corollary principle: Where harm cannot be avoided, we are obligated to minimize the harm we do.</p> <p>We have an obligation to provide others with whatever they are owed or deserve. In public life, we have an obligation to treat all people equally, fairly, and impartially. Corollary principle: Impose no unfair burdens.</p> |

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| <p><u>ETHICAL DILEMMA</u> MEANING:</p> | <p>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.</p> <p>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.</p> <p>The ethical dilemma consideration takes us into the grey zone of business and professional life, where things are no longer black or white and where ethics has its vital role today.</p> |
| | <p>Steps to Resolving an Ethical Dilemma</p> |
| | <ol style="list-style-type: none"> 1. Considering the options available: List the alternative courses of action available. 2. Considering Consequences – positives and negatives of each option : Think carefully about the range of positive and negative consequences associated with each of the different paths of action available. 3. Analysing Actions: Actions should be analysed in a different perspective . How do the options measure up against moral principles like honesty, fairness, equality, and recognition of social and environmental vulnerability? In the case you are considering, is there a way to see one principle as more important than the others? 4. Decision Making and Commitment: Once the decision is made, act on the decision assuming responsibility for it. 5. Evaluate the System: Think about the circumstances which led to the dilemma with the intention of identifying and removing the conditions that allowed it to arise. |

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| <p>CODE OF ETHICS:</p> | <p>Managers at all levels and in all functional areas face ethical issues. Organisations, formulate both business and non-business guidelines in the form of a code of conduct or code of ethics. The need for a corporate code of conduct has increased due to frequent corporate scandals, inside trading and misuse of funds. 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 code of ethics should reflect top managements' desire for compliance with the values, rules, and policies that support an ethical climate. The development of a code of ethics should involve the President, Board of Directors, and Chief Executive Officers who should be implementing the code.</p> <p>The six values that are desirable for codes of ethics include:</p> <ul style="list-style-type: none"> ➤ trustworthiness, ➤ respect, ➤ responsibility, ➤ fairness, ➤ caring, and ➤ citizenship. <p>In the United States of America, Section 406 of the Sarbanes Oxley Act, 2002 requires public companies to disclose whether they have codes of ethics, and also to disclose any waivers of those codes for certain members of senior management. Section 406(a) of the Regulation requires companies to disclose: –</p> <ul style="list-style-type: none"> ➤ 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. ➤ any changes to the code of ethics. ➤ If companies do not have a code of ethics, they must explain why they have not adopted one. A company may file its codes as an exhibit in the annual report, post the codes on the company's website, or agree to provide a copy of the codes upon request and without charge. |
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CODE OF CONDUCT:

The Code of conduct or what is popularly known as the **Code of Business Conduct contains standards of business conduct that must guide** actions of the Board of Directors and senior management of the company. The Code of Conduct outlines specific behaviours that are required or prohibited as a condition of ongoing Employment.

A well-written code of conduct clarifies an organization’s mission, values and principles, linking them with standards of professional conduct. The code articulates the values the organization wishes to foster in leaders and employees and, in doing so, defines desired behavior. As a result, written codes of conduct or ethics can become benchmarks against which individual and organizational performance can be measured. organizational performance can be measured. The code of conduct may include the following:

- **Company Values.**
- **Avoidance of conflict of interests .**
- **Accurate and timely disclosure in reports and documents that the company files before Government agencies, as well as in the company’s other communications .**
- **Compliance of applicable laws, rules and regulations including Insider Trading Regulations .**
- **Maintaining confidentiality of the company affairs.**

| BASIS FOR COMPARISON | CODE OF ETHICS | CODE OF CONDUCT |
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| (a) Meaning: | An aspirational document, issued by the board of directors containing core ethical values, principles and ideals of the organization is Code of Ethics. | A directional document containing specific practices and behavior, that are followed or restricted under the organization is Code of Conduct. |
| (a) Nature: | General | Specific |
| (b) Scope: | Wide | Narrow |
| (c) Disclosures: | Publicly disclosed | Employees |
| (d) Focused on: | Values or Principles | |

Both a Code of Ethics and a Code of Conduct are similar as they are used in an attempt to encourage specific forms of behaviour by employees. Ethics guidelines attempt to provide guidance about values and choices to influence decision making. Conduct regulations assert that some specific actions are appropriate, others in appropriate. In both cases, the organization’s desire is to

| | General Moral Imperatives |
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| | <p>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.</p> <p>“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.</p> |

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| <p>INDIAN ETHOS</p> | <p>The essence of good governance and leadership lies not in the paraphernalia of systems and procedures but on the quality of people who create, govern or operate the systems. In Indian ethos it is known as Swadharma of each individual.</p> <p>The present ethical debate in the corporate world is focused mostly on values like honesty, integrity, fairness or transparency. But the scope of ethics is not confined to these values only.</p> |
| <p>ADVANTAGES OF BUSINESS ETHICS</p> | <p>A company that adheres to ethical values and dedicatedly takes care of its employees is rewarded with equally loyal and dedicated employees.</p> <ul style="list-style-type: none"> ➤ 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. ➤ 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. ➤ 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. ➤ Regulators: <ul style="list-style-type: none"> • 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. |

SOME EXAMINATION QUESTIONS

- 1.** Discuss about the influence of organization climate and organizational structure on the ethics programme of a company.
- 2.** Describe Ethical Dilemma.
- 3.** What are the advantages of Business Ethics for an organization?
- 4.** What are the objectives and advantages of a Code of Conduct for a company?
- 5.** What is the difference between a Code of ethics and a Code of Conduct?

CHAPTER 17
CSR and Sustainability

CORPORATE SOCIAL RESPONSIBILITY (CSR)

CSR: 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.

Essentially, Corporate Social Responsibility is an inter-disciplinary subject in nature and encompasses in its fold:

- **Social, economic, ethical and moral responsibility of companies and managers,**
- **Compliance with legal and voluntary requirements for business and professional practice,**
- **Challenges posed by needs of the economy and socially disadvantaged groups, and**
- **Management of corporate responsibility activities.**

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| WHY CSR AT ALL? | <ul style="list-style-type: none"> ➤ 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. ➤ 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. ➤ Public needs have changed leading to changed expectations from consumers. The industry/ business owes its very existence society and has to respond to needs of the society. ➤ 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. ➤ 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 | <p>Many factors and influences, including the following, have led to increasing attention being devoted to CSR:</p> <ul style="list-style-type: none"> ➤ 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. |

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| | <ul style="list-style-type: none"> ➤ 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. ➤ 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. |
| <p>TRIPLE BOTTOM LINE APPROACH OF CSR</p> | <ul style="list-style-type: none"> ➤ Within the broader concept of corporate social responsibility, the concept of Triple Bottom Line (TBL) is gaining significance and becoming popular amongst corporates. ➤ 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. |
| <p>The need to apply the concept of TBL is caused due to –</p> | <ul style="list-style-type: none"> ➤ 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. |
| <p>GLOBAL PRINCIPLES AND GUIDELINES</p> | <p>A comprehensive guidance for companies pertaining to CSR is available in the form of several globally recognised guidelines, frameworks, principles and tools, some of which are discussed below.</p> <ul style="list-style-type: none"> ➤ The UN Guiding Principles on Business and Human Rights: The UN guiding principles provide assistance to states and businesses to fulfil |

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| | <p>their existing obligations towards respecting and protecting human rights and fundamental freedoms and comply with the existing laws. These principles act as global standards for addressing the risk of human rights violation related to business activity. In circumstances when these laws are breached or the guidance is not adhered to, suitable remedies have also been recommended.</p> <ul style="list-style-type: none"> ➤ OECD Guidelines: Multinational enterprises: OECD Guidelines for multinational enterprises elaborate on the principles and standards for responsible business conduct for multinational corporations. These guidelines were recently updated in 2011. They cover areas such as employment, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition and taxation ➤ Institute of Social and Ethical Accountability: AccountAbility's AA1000 series of standards: This is a series of standards which enable organisations to become accountable, responsible and sustainable. It consists of the (i) AA1000 accountability principles (AP) standard (ii) AA1000 assurance standard (AS) (iii) AA1000 stakeholder engagement (SE) standard. ➤ Social Accountability International (SAI): SA 8000 Standard: This is one of the world's first auditable social certification standard. It is based on ILO, UN and national law conventions, and adopts a management system approach in order to ensure that companies that adopt this approach also comply with it. This standard ensures the protection of basic human rights of workers. The nine basic elements of this standard include (i) child labour (ii) forced and compulsory labour (iii) health and safety (iv) freedom of association and the right to collective bargaining (v) discrimination (vi) disciplinary practices (vii) working hours (viii) remuneration (ix) management systems. ➤ ISO 26000: Social responsibility: ISO 26000 is the international standard giving guidance on social responsibility and is intended for use by organizations of all types both public and private sectors, in developed and developing countries. It covers six core areas of social responsibility, including (i) human rights (ii) labour practices (iii) environment (iv) fair operating practices (v) consumer issues (vi) community involvement and development. ➤ The Global Compact Self Assessment Tool is an easy-to-use guide designed for use by companies of all sizes and across sectors committed to upholding the social and environmental standards within their respective operations |
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CORPORATE SUSTAINABILITY

Sustainability means meeting of the needs of the present without compromising the ability of future generations to meet theirs. It has **three main pillars:**

- economic,
- environmental, and
- social.

These **three pillars** are informally referred to as

- people,
- planet and
- profits.

These three Ps have its **priority orders too**. One should take **first take care of the PEOPLE** and thereafter the **PLANET**. **PROFIT is an economic activity** and is much for the survival of the unit, but in the array of these three Ps, its priority should stand in last and not at the cost of People and Planet.

Sustainability is important to make sure that we have and will continue to have the **water, materials, and resources to protect human health and our environment**.

Corporate sustainability indicates new philosophy, as an alternative to the traditional growth and profitmaximization model, under which sustainable development comprising of environmental protection, social justice and equity, and economic development are given more significant focus while recognizing simultaneous growth of the corporate and profitability. It is a business approach that **creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments**.

Corporate sustainability encompasses strategies and practices that aim to meet the needs of the stakeholders today while seeking to protect, support and enhance the human and natural resources that will be the need of the future. **Corporate sustainability leaders achieve long-term shareholder value**.

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| <p>Following key drivers need to be garnered to ensure sustainability:</p> | <ul style="list-style-type: none"> ➤ Internal Capacity Building strength – In order to convert various risks into competitive advantages. ➤ Social impact assessment – In order to become sensitive to various social factors, like changes in culture and living habits. ➤ Repositioning capability through development and innovation: Crystallisation of all activities to ensure consistent growth. ➤ Corporate sustainability is a business approach creating shareholder value in the long run. |
| <p>UNITED NATIONS GLOBAL COMPACT'S TEN PRINCIPLES, 2000</p> | <ol style="list-style-type: none"> 1. Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and 2. Principle 2: make sure that they are not complicit in human rights abuses. 3. Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining; 4. Principle 4: the elimination of all forms of forced and compulsory labour; 5. Principle 5: the effective abolition of child labour; and 6. Principle 6: the elimination of discrimination in respect of employment and occupation. 7. Principle 7: Businesses should support a precautionary approach to |

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| | <p>environmental challenges;</p> <p>8. Principle 8: undertake initiatives to promote greater environmental responsibility; and</p> <p>9. Principle 9: encourage the development and diffusion of environmentally friendly technologies.</p> <p>10. Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.</p> |
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CSR AND SUSTAINABILITY IN INDIA

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| Corporate Social Responsibility Voluntary Guidelines, 2009 | <p>The Corporate Social Responsibility Voluntary Guidelines issued by the MCA in December 2009 was the first step towards mainstreaming the concept of Business Responsibilities. Through these Guidelines, the Ministry urged the business sector to adopt the principles contained in the Guidelines for responsible business practices. It was recommendatory initiative to underline that the business sector also needs to take the responsibility of exhibiting socially responsible business practices that ensures the distribution of wealth and well-being of the communities in which the business operates.</p> |
| National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business – 2011 | <p>Keeping in view the feedback from stakeholders, review of 2009 Guidelines was undertaken by the Guidelines Drafting Committee (GDC) constituted by the Indian Institute of Corporate Affairs, resulting into the formulation of 2011 Guidelines entitled “National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business” to mainstream the subject of business responsibilities.</p> <p>These guidelines were formulated keeping in view the diverse sectors within which businesses operate, as well as the wide variety of business organizations that exist in India today – from the small and medium enterprises to large corporate organizations.</p> |
| <p>Principles and the core elements The principles and the core elements of each of the principles as recommended by the National Voluntary Guidelines are summarized below:</p> | |
| Principles | Core Elements |
| Principle 1: Businesses should conduct and govern themselves with Ethics, Transparency and Accountability | <p>The principle recognizes that ethical conduct in all functions and processes is the cornerstone of responsible business.</p> <ol style="list-style-type: none"> 1. Businesses should not engage in practices that are abusive, corrupt, or anti-competition. 2. Businesses should truthfully discharge their responsibility on financial and other mandatory disclosures. 3. Businesses should report on the status of their adoption of these Guidelines as suggested in the reporting framework in NVG’s. 4. Businesses should avoid complicity with the actions of any third party that violates any of the principles contained in these Guidelines. |

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| <p>Principle 2: Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle</p> | <p>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.</p> <ol style="list-style-type: none"> 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. In designing the product, businesses should ensure that the manufacturing processes and technologies required to produce it are resource efficient and sustainable. 3. Businesses should regularly review and improve upon the process of new technology development, deployment and commercialization, incorporating social, ethical, and environmental considerations. 4. Businesses should recognize and respect the rights of people who may be owners of traditional knowledge, and other forms of intellectual property. |
| <p>Principle 3: Businesses should promote the well being of all employees</p> | <p>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.</p> <ol style="list-style-type: none"> 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. |
| <p>Principle 4: Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized.</p> | <p>The principle recognizes that businesses have a responsibility to think and act beyond the interests of its shareholders to include all their stakeholders.</p> <ol style="list-style-type: none"> 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. |
| <p>Principle 5: Businesses should respect and promote</p> | <p>The principle takes into account the “Corporate Responsibility to Respect Human Rights”, as referred in the United Nations “Protect, Respect, Remedy” Framework.</p> |

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| <p>human rights</p> | <ol style="list-style-type: none"> 1. 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. 2. Businesses should, within their sphere of influence, promote the awareness and realization of human rights across their value chain. 3. Businesses should not be complicit with human rights abuses by a third party. 4. 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. |
| <p>Principle 6: Business should respect, protect, and make efforts to restore the environment.</p> | <p>The principle recognizes that environmental responsibility is a prerequisite for sustainable economic growth and for the well being of society.</p> <ol style="list-style-type: none"> 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 proactively persuade and support its value chain to adopt this principle. |
| <p>Principle 7: Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner</p> | <p>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.</p> <ol style="list-style-type: none"> 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. |
| <p>Principle 8: Businesses should support inclusive growth and equitable development</p> | <p>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.</p> <ol style="list-style-type: none"> 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. |
| <p>Principle 9: Businesses should engage with and provide value to their</p> | <p>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.</p> <ol style="list-style-type: none"> 1. Businesses, while serving the needs of their customers, should take |

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| customers and consumers in a responsible manner | <p>into account the overall well-being of the customers and that of society.</p> <ol style="list-style-type: none"> 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 provide adequate grievance handling mechanisms to address customer concerns and feedback. |
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The Companies Act, 2013

The Act brought the concept of Corporate Social Responsibility in India to the forefront. It aimed to promote greater transparency and disclosure. The Ministry of Corporate Affairs through Section 135 and **Schedule VII of the Companies Act 2013 as well as the Companies (Corporate Social Responsibility Policy) Rules, 2014 mandated the provisions of the corporate social responsibility for certain classes of companies.**

SEBI (LODR) Regulations, 2015

In line with the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business and considering the larger interest of public disclosure regarding steps taken by listed entities, SEBI has mandated the requirement of **submission of Business Responsibility Report ('BRR') for top 500 listed entities under Regulation 34(2)(f) of SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 ("SEBI LODR").**

National Guidelines on Responsible Business Conduct (NGRBC), 2019

In March 2019, the Ministry of Corporate Affairs has revised the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 (NVGs) and has released the National Guidelines on Responsible Business Conduct (NGRBC). These guidelines urge businesses to actualise the principles in letter and spirit.

The MCA has been taking various initiatives for ensuring responsible business conduct by companies. As a first step towards mainstreaming the concept of business responsibility, the Voluntary Guidelines on Corporate Social Responsibility were issued in 2009. These guidelines were subsequently revised as National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business in 2011 after extensive consultations with business, academia, civil society organisations and the government.

- The nine thematic pillars of business responsibility provided by the NGBRC are**
1. **Businesses should conduct and govern themselves with integrity in a manner that is Ethical, Transparent and Accountable.**
 2. **Businesses should provide goods and services in a manner that is sustainable and safe.**
 3. **Businesses should respect and promote the well-being of all employees, including those in their value chains.**
 4. **Businesses should respect the interests of and be responsive to all their stakeholders.**

5. **Businesses should respect and promote human rights.**
6. **Businesses should respect and make efforts to protect and restore the environment.**
7. **Businesses, when engaging in influencing public and regulatory policy, should do so in a manner that is responsible and transparent.**
8. **Businesses should promote inclusive growth and equitable development.**
9. **Businesses should engage with and provide value to their consumers in a responsible manner.**

| SUSTAINABLE DEVELOPMENT | |
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| SUSTAINABLE DEVELOPMENT | <p>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.</p> <p>The goal of sustainable development is to maintain economic growth without environment destruction. Exactly what is being sustained (economic growth or the global ecosystem, or both) is currently at the root of several debates, although many scholars argue that the apparent reconciliation of economic growth and the environment is simply a green sleight of hand that fails to address genuine environmental problems.</p> <p>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.</p> |
| Four fundamental Principle of Sustainable Development agreed by the world community are: | <ol style="list-style-type: none"> 1. Principle of Intergenerational equity: need to preserve natural resources for the future generations. 2. Principle of sustainable use: use of natural resources in a prudent manner without or with minimum tolerable impact on nature. 3. Principle of equitable use or intra-generational equity: Use of natural resources by any state / country must take into account its impact on other states. 4. Principle of integration: Environmental aspects and impacts of socio-economic activities should be integrated so that prudent use of natural resources is ensured. |

United Nations Conference on Human Environment

The United Nations Conference on the Human Environment (also known as the Stockholm Conference) was an international conference convened under United Nations auspices held in Stockholm, Sweden

from June 5-16,1972. It was the UN's first major conference on international environmental issues, and marked a turning point in the development of international environmental politics. One of the key issues addressed was the use of CFCs (chlorofluorocarbons) which were thought to be responsible for the depletion of the ozone layer. The Stockholm Conference laid a framework for future environmental cooperation; led to the creation of global and regional environmental monitoring networks and the creation of the United Nations Environment Programme.

United Nations Environment Programme

“To provide leadership and encourage partnership in caring for the environment by inspiring, informing, and enabling nations and peoples to improve their quality of life without compromising that of future generations.”

The major Milestones of the UNEP include: –

- **1973 - Convention on International Trade in Endangered Species (CITES)**
- **1985 - Vienna Convention for the Protection of the Ozone Layer**
- **1987 - Montreal Protocol on Substances that Deplete the Ozone Layer**
- **1988 - Intergovernmental Panel on Climate Change (IPCC)**
- **1989 - Basel Convention on the Transboundary Movement of Hazardous Wastes**
- **1992 - UN Conference on Environment and Development (Earth Summit) publishes Agenda 21, a blueprint for sustainable development**
- **1992 - Convention on Biological Diversity**
- **2000 - Malmö Declaration - first Global Ministerial Forum on the Environment calls for strengthened international environmental governance**
- **2000 - Millennium Declaration - environmental sustainability was included as one of eight Millennium Development Goals**
- **2002 - World Summit on Sustainable Development**
- **2004 - Bali Strategic Plan for Technology Support and Capacity Building**
- **2005 - World Summit outcome document highlights key role of environment in sustainable development**
- **2012 - The United Nations Conference on Sustainable Development (Rio+20)**
- **2013-15 – High level Political Forum on Sustainable Development**
- **2015 – United Nations Sustainable Development Summit, 2015 (New York)**

Brundtland Commission

The Brundtland Commission, formally the World Commission on Environment and Development (WCED), known by the name of its Chairman Gro Harlem Brundtland, was convened by the United Nations in 1983. The Commission was created to address growing concern “about the accelerating deterioration of the human environment and natural resources and the consequences of that deterioration for economic and social development.” In establishing the Commission, the UN General Assembly recognized that environmental problems were global in nature and determined that it was in the common interest of all nations to establish policies for sustainable development.

The Report of the Brundtland Commission, Our Common Future, published in 1987, deals with sustainable development and the change of policies needed for achieving that. The definition of this term in the report is quite well known and often cited:

“Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”

United Nations Conference on Environment and Development

The United Nations Commission on Sustainable Development (CSD) was established by the UN General Assembly in December 1992 to ensure effective follow-up of United Nations Conference on Environment and Development (UNCED) (known as the Earth Summit) held in Rio De Janeiro. The following documents were the outcome of the Rio Summit:

- **Agenda 21 – is a blueprint on how to make development socially, economically and environmentally sustainable.**
- **The Rio Declaration on Environment and Development – it has 27 principles defining the rights and responsibilities of nations as they pursue human development and well-being.**
- **A statement of forest principles – they guide the management, conservation and sustainable development of all types of forests, as essential to economic development and the maintenance of all forms of life.**
- **The United Nations Framework Convention on Climate Change – aims to stabilize greenhouse gas concentrations in the atmosphere at levels that would prevent dangerous human induced interference with the climate system.**
- **The Convention on Biological Diversity – it requires the countries to adopt ways and means to conserve the variety of living species, and ensure that the benefits from using biological diversity are equitably shared.**
- **Montreal Protocol on Substances that Deplete the Ozone Layer was designed to reduce the production and consumption of ozone depleting substances.**

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 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).**

Bali Roadmap

At the 2007 United Nations Climate Change Conference in Bali, Indonesia in December, 2007, the participating nations adopted the Bali Roadmap as a two-year process for finalizing a binding agreement in 2009 in Denmark.

The Bali Road Map consists of a number of forward-looking decisions that represent the various tracks essential to reaching a secure climate future. The Bali Road Map includes the Bali Action Plan, which charts the course for a new negotiating process designed to tackle climate change, with the aim of completing this by 2009. To conduct the process, a subsidiary body under the Convention called the Ad Hoc Working Group on Long-term Cooperative Action under the Convention (AWG-LCA) was set up.

To discuss future commitments for industrialized countries under the Kyoto Protocol, the Conference of the Parties serving as the Meeting of the Parties to the Kyoto Protocol established a working group in December 2005, called the Ad Hoc Working Group on further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP).

United Nations Conference on Sustainable Development, Rio+20

The United Nations Conference on Sustainable Development - or Rio+20 - took place in Rio de Janeiro, Brazil on 20-22 June 2012. It resulted in a focused political outcome document **which contains clear and practical measures for implementing sustainable development.**

In Rio, Member States decided to launch a process to develop **a set of Sustainable Development Goals (SDGs)**, which will build upon the Millennium Development Goals and converge with the post 2015 development agenda.

Following are some commitments adopted under Rio+20 outcome document:

1. **Poverty Eradication:** poverty eradication should be given highest priority within UN agenda;
2. **Food Security and Nutrition and Sustainable Agriculture:** commitment of the right of everyone to have access to safe, sufficient and nutritious food, importance of sustainable agriculture and recognition to the importance of addressing the access of rural communities to credit, financial services, markets, land tenure, health care and social services;
3. **Energy: critical role of energy in sustainable development** – access to sustainable modern energy contributes to poverty eradication, saves lives and improves health, essential to social inclusion and gender equality.
4. **Sustainable transport:** importance of environmentally sound, safe and affordable transportation as a means to improve social equity and health. Support development of sustainable transport systems, notably public mass transportation systems. Acknowledge that developing countries need assistance.
5. **Sustainable cities:** well planned and integrated cities can be economically, socially and environmentally sustainable - including housing, safe and healthy living environment for all, particularly the vulnerable; affordable and sustainable transport and energy, promotion and protection of safe and green urban spaces, water and sanitation, air quality, decent jobs and improved urban planning and slum upgrading. Recognize importance of mixed-use planning and non-motorized mobility - including by promoting pedestrian and cycling infrastructures.
6. **Health and population:** Health is a precondition for an outcome of and an indicator of all three dimensions of sustainable development. Sustainable development cannot be achieved in the presence of high burden on communicable/non communicable diseases.

THE 2030 AGENDA FOR SUSTAINABLE DEVELOPMENT

Sustainable Development Goals

1. **Goal 1.** End poverty in all its forms everywhere
2. **Goal 2.** End hunger, achieve food security and improved nutrition and promote sustainable agriculture
3. **Goal 3.** Ensure healthy lives and promote well-being for all at all ages
4. **Goal 4.** Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
5. **Goal 5.** Achieve gender equality and empower all women and girls
6. **Goal 6.** Ensure availability and sustainable management of water and sanitation for all
7. **Goal 7.** Ensure access to affordable, reliable, sustainable and modern energy for all
8. **Goal 8.** Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
9. **Goal 9.** Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
10. **Goal 10.** Reduce inequality within and among countries
11. **Goal 11.** Make cities and human settlements inclusive, safe, resilient and sustainable
12. **Goal 12.** Ensure sustainable consumption and production patterns
13. **Goal 13.** Take urgent action to combat climate change and its impacts*
14. **Goal 14.** Conserve and sustainably use the oceans, seas and marine resources for sustainable development
15. **Goal 15.** Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
16. **Goal 16.** Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
17. **Goal 17.** Strengthen the means of implementation and revitalize the global partnership for sustainable development SUSTAINABILITY.

SUSTAINABILITY INDICES

- A. **DOW-JONES SUSTAINABILITY INDEX:** The Dow Jones Sustainability Indices are the first global indices tracking the financial performance of the leading sustainability-driven companies worldwide, it was launched in 1999. The Dow Jones Sustainability World Index (DJSI World) comprises more than 300 companies that represent the top 10% of the leading sustainability companies out of the biggest 2500 companies in the Dow Jones World Index. In addition to the composite DJSI World, there are six specialized subset indexes excluding alcohol, ex gambling, ex tobacco, ex armaments & firearms, ex alcohol, tobacco, gambling, armaments & firearms indexes, and ex alcohol, tobacco, gambling armaments & firearms, and adult entertainment.

- B. ENVIRONMENT, SOCIAL, GOVERNANCE (ESG) INDEX** ESG describes the environmental, social and corporate governance issues that investors are considering in the context of corporate behaviour. Integration of ESG refers to the active investment management processes that include an analysis of environmental, social, and corporate governance risks and opportunities and sustainability aspects of company performance evaluation. The ESG index employs a unique and innovative methodology that quantifies a company’s ESG practices and translates them into a scoring system which is then used to rank each company against its peers in the market. Its quantitative scoring system offers investors complete transparency on Environmental, Social & governance issues of a company.
- C. STANDARD & POOR’S ESG INDIA INDEX** Standard & Poor’s ESG India index provides investors with exposure to a liquid and tradable index of 50 of the best performing stocks in the Indian market as measured by environmental, social, and governance parameters. The index employs a unique and innovative methodology that quantifies a company’s ESG practices and translates them into a scoring system which is then used to rank each company against their peers in the Indian market. Its quantitative scoring system offers investors complete transparency. The creation of the index involves a two step process, the first of which uses a multi-layered approach to determine an ‘ESG’ score for each company. The second step determines the weighting of the index by score. Index constituents are derived from the top 500 Indian companies by total market capitalizations that are listed on National Stock Exchange of India Ltd. (NSE). These stocks are then subjected to a screening process which yields a score based on a company’s ESG disclosure practices in the public domain.

MEASURING BUSINESS SUSTAINABILITY

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| ALTMAN Z-SCORE | <ul style="list-style-type: none"> ➤ The Altman Z Score model is a financial model to predict the likelihood of bankruptcy in a company. It was created by Edward I. Altman, a professor at the Leonard N. Stern School of Business of New York University. ➤ The formula helps to predict the probability of a firm to go into bankruptcy within next two years ➤ Z-scores are used to predict corporate defaults and an easy-to-calculate control measure for the financial distress status of companies. The purpose of the Z Score Model is to measure a company’s financial health and to predict the probability that a company will collapse within 2 years. ➤ The Z-Score does not apply to every situation. It can only be used for forecasting if a company being analyzed can be compared to the database. ➤ Formula Z-Score = 1.2A + 1.4B + 3.3C + 0.6D + 1.0E <p>Where:</p> <ul style="list-style-type: none"> • A = working capital / total assets: -This ratio measures liquid assets. The companies in trouble will usually experience shrinking liquidity. |
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| | <ul style="list-style-type: none"> • B = retained earnings / total assets: -This ratio calculates the overall profitability of the company. Dwindling profitability is a warning sign. • C = earnings before interest and tax / total assets: -This ratio shows how productive a company is in generating earnings, relative to its size. • D = market value of equity / total liabilities: - This ratio suggests how far the company’s assets can decline before it becomes technically insolvent (i.e., its liabilities become higher than its assets). • E = sales / total assets:-This is the asset turnover ratio and is a measure of how effectively the firm uses its assets to generate sales. <p>A Z score of greater than 2.99 means that the entity being measured is safe from bankruptcy. A score of less than 1.81 means that a business is at considerable risk of going into bankruptcy, while scores in between should be considered a red flag for possible problems.</p> |
| <p>RISK-ADJUSTED RETURN ON CAPITAL - RAROC</p> | <p>Risk-adjusted return on capital (RAROC) is a profitability metric that can be used to analyse return in relation to the level of risk taken on. It can be used to compare the performance of several investments with differing levels of risk exposure. It should not be confused with RORAC (return on risk-adjusted capital) which adjusts the capital invested based on the risks being taken. RAROC instead adjusts the return itself. RAROC was developed by Bankers Trust in the late 1970s and early 1980s in response to regulatory interest in the capital ratios of financial institutions and the implementation of capital adequacy regulations. RAROC is often used by banks to determine the amount of capital required to support the bank’s activities.</p> <p>RAROC system allocates capital for two basic reasons:</p> <ul style="list-style-type: none"> • Risk management • Performance evaluation <p>Risk-adjusted return on capital (RAROC) is a modified return on investment (ROI) figure that takes elements of risk into account. The formula used to calculate RAROC is:</p> <p>RAROC: Revenue-Expenses-Expected loss+Income from capital/Capital</p> <p>Where:</p> <ul style="list-style-type: none"> ➤ Income from capital = (capital charges) × (risk-free rate) ➤ This is calculated by multiplying capital charges by the risk-free rate. This is because, since capital is set aside to support a risky transaction, it should theoretically be invested in something ‘risk free’. ➤ Expected loss is the average anticipated loss over the period being |

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| | <p>measured. It will include the cost of doing business as well as any loss incurred from default or operational risk.</p> <ul style="list-style-type: none"> ➤ Capital means economic capital is the amount of capital that a financial institution needs to ensure that the company remains solvent. It should be sufficient to support any risks that the company takes on. |
| <p>ECONOMIC VALUE ADDED (EVA)</p> | <p>“Economic Value Added (EVA) is the net operating profit minus an appropriate charge for the opportunity cost of all capital invested in an enterprise or project. It is an estimate of true economic profit, or amount by which earnings exceed or fall short of the required minimum rate of return investors could get by investing in other securities of comparable risk (Stewart, 1990).”</p> <p>EVA is net operating profit after tax less capital charge. Or, EVA = NOPAT- (Invested Capital × WACC).</p> |
| <p>MARKET VALUE ADDED (MVA)</p> | <p>Market Value Added (MVA) is a tool to measure shareholder’s value at a particular moment; this was introduced by Stewart in 1991. Market Value Added (MVA) is the additional market capitalization over and above the book value of equity (Gupta & Kundu, 2008). From an investor’s point of view, MVA is the best final measure of a Company’s performance.</p> <p>It is typically used for companies that are larger and publicly-traded. MVA is not a performance metric like EVA, but instead is a wealth metric, measuring the level of value a company has accumulated over time.</p> <p>In another words Market Value Added (MVA) is the difference between the current market value of a firm (V) and the capital contributed by its investors (K):</p> <p>Market Value Added (MVA) = V – K</p> <p>The link between EVA and MVA is that MVA is the present value of all the future EVAs a Company is expected to generate, discounted at the WACC.</p> <p>Market Value Added (MVA) = PV (EVA) Theoretically, MVA is equal to the present value of all future EVAs.</p> |
| <p>SUSTAINABLE VALUE ADDED</p> | <p>Traditionally, an enterprise focuses on value maximization. The conventional management takes into account just one dimension – economic – when creating value in an enterprise. All resources including environmental and social resources are neglected. This point of view is not acceptable when speaking about sustainable development. Over the last decades, theorists emphasize wider scope of entrepreneurial objectives besides obtaining the greatest value possible.</p> <p>Sustainable development is a normative concept laid out as the combination of economic prosperity, environmental integrity and social equity. Value is created whenever benefits exceed costs. Sustainable Value Added takes into account both, the efficiency and the absolute level (effectiveness) of</p> |

resource use. It has never been more important for businesses to use their economic, environmental and social resources efficiently. Conceptually, SVA stresses the complementary disposition of economic, environmental and social resources. **Sustainable Value Added is the extra value created when the overall level of environmental and social impacts is kept constant.**

Current approaches to measure corporate sustainable performance take into account external costs caused by environmental and social damage or focus on the ratio **between value creation and resource consumption.**

SOME EXAMINATION QUESTIONS

1. Discuss about the influence of organization climate and organizational structure on the ethics programme of a company.
2. Describe Ethical Dilemma.
3. What are the advantages of Business Ethics for an organization?
4. What are the objectives and advantages of a Code of Conduct for a company?
5. What is the difference between a Code of ethics and a Code of Conduct?

CHAPTER 18
Anti-Corruption and Anti-Bribery Laws in India

DELHI SPECIAL POLICE ESTABLISHMENT ACT, 1946

The Central Bureau of Investigation traces its **origin to the Special Police Establishment (SPE) which was set up in 1941 by the Government of India**. The preamble of the Act provides that it is an Act to make provision for the constitution of a special police force 2 in Delhi for the **investigation of certain offences in the Union territories for the superintendence and administration** of the said force and for the extension to other areas of the powers and jurisdiction of members of the said force in regard to the investigation of the said offences.

The functions of the SPE then were **to investigate cases of bribery and corruption in transactions with the War & Supply Deptt. of India** during World War II. Even after the end of the War, the need for a Central Government agency to investigate cases of bribery and corruption by Central Government employees was felt. The Delhi Special Police Establishment Act was therefore brought into force in 1946. **The CBI's power to investigate cases is derived from this Act.**

UNLAWFUL ACTIVITIES (PREVENTION) ACT, 1967

The Central Government's enactment was provided with the short title as 'the **Unlawful Activities (Prevention) Act, 1967**' to make provisions as to more effective prevention of Individual's and associations' certain unlawful activities. The **Act was amended by the Unlawful Activities (Prevention) Amendment Act, 2004 and also the Amending Act of 2008** for adding in its long title, the object of dealing with the Terrorist Activities. The provisions of the **Act extended to the whole of India. So far as the applicability of the provisions of the Act** to persons are concerned, the **section 1 itself says that all persons who commits any act or omission which is contrary to the provisions of this Act, should be held guilty in India**, and be punished under this Act. Even commission of such acts or omission contrary to the provisions of this Act out side India, is also to be treated, as the same has been committed in India. The **Act makes its provisions under different seven chapters:**

- **The first chapter** is making preliminary provisions of the Act, including short title, extension, etc.
- **The second chapter** makes provisions as to unlawful associations.
- **The next chapter** of the Act makes penal provisions.
- **The fourth chapter** of the Act makes provisions for penal provisions as to terrorist activities.
- **The fifth chapter** of the Act deals with the forfeiture of proceeds of terrorism or any property intended to be used for terrorism.
- **The sixth chapter** of the Act makes provisions as to terrorist organization, where the Organisations which are identified as a terrorist one, in the Resolution adopted by the Security Council of UN, should be added to the Schedule of this Act by the Central Government. Similarly, removal of any organisation can also be made by the Central Government under this Act.

- **The seventh chapter** of the Act makes miscellaneous provisions, wherein the Central Government is empowered to direct delegation of powers to the State Government and such State Government can also with the prior approval from the Centre, direct the delegation of those powers to any person subordinate to it.

| FOREIGN CORRUPT PRACTICES ACT, 1977 (THE FCPA) | |
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| APPLICABILITY: | <ul style="list-style-type: none"> ➤ The FCPA applies to any person who has a certain degree of connection to the United States and engages in foreign corrupt practices. ➤ The Act also applies to any act by U.S. businesses, foreign corporations trading securities in the U.S., American nationals, citizens, and residents acting in furtherance of a foreign corrupt practice whether or not they are physically present in the U.S. |
| OBJECTIVES: | <ul style="list-style-type: none"> ➤ This act was passed to make it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business . Further, the Act governs not only payments to foreign officials, candidates, and parties, but any other recipient if part of the bribe is ultimately attributable to a foreign official, candidate, or party. These payments are not restricted to monetary forms and may include anything of value. This is considered the territoriality principle of the act. |

| PREVENTION OF CORRUPTION ACT, 1988 (THE PCA) |
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| <p>The PCA criminalises the acceptance of gratification (pecuniary or otherwise) other than the acceptance of legal remuneration by public servants which is paid by their employers in connection with the performance of their duties. Aiding and abetting the commission of bribery is also an offence, such that any person, who bribes or attempts to bribe a public servant or acts as a middleman for such bribing may also be held liable. It extends to the whole of India except the State of Jammu and Kashmir and it applies also to all citizens of India outside India. The PCA is primarily directed at public servants, which is broadly defined to include any person who is:</p> <ul style="list-style-type: none"> ➤ In the service or pay of the Government, local authority, Government corporation. ➤ Related to the administration of justice. ➤ Empowered to conduct elections. ➤ Appointed to perform public duty. ➤ An office bearer of Government aided cooperative society. ➤ An employee of any service commission. ➤ A member of any university. <p>Persons authorised to investigate: Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), no police officer below the rank,</p> <ul style="list-style-type: none"> ➤ in the case of the Delhi Special Police Establishment, of an Inspector of Police; ➤ in the metropolitan areas of Bombay, Calcutta, Madras and Ahmedabad and in any other metropolitan area notified as such under sub-section (1) of section 8 of the Code of Criminal Procedure, 1973 (2 of 1974), of an Assistant Commissioner of Police; |

- elsewhere, of a **Deputy Superintendent of Police or a police officer of equivalent rank, shall investigate any offence punishable under this Act** without the order of a Metropolitan Magistrate or a Magistrate of the first class, as the case may be, or make any arrest therefor without a warrant: Provided that if a **police officer not below the rank of an Inspector** of Police is authorised by the State Government in this behalf by general or special order, he may also investigate any such offence without the order of a **Metropolitan Magistrate or a Magistrate of the first class**, as the case may be, or **make arrest therefor without a warrant**: Provided further that an offence referred to in clause (e) of sub-section (1) of section 13 **shall not be investigated without the order of a police officer not below the rank of a Superintendent of Police.**

Liability of individual directors and officers: The PCA **does not specifically impose liability on directors and officers of a corporate entity** for the company's commission of an offence of corruption. However, as indicated above, the abetment of bribery of public servants is also an offence. **The Companies Act, 2013 enshrines the concept of an 'officer in default'** who shall be liable for the acts of the company. An officer in default is specifically held to be liable in cases where such officer is aware of the contravention of the provisions of the legislation by virtue of receipt of any proceedings or any participation without objecting to the same. That said, **if such officer is able to establish that he or she acted honestly and reasonably, he or she may be exonerated in certain circumstances.**

| CENTRAL VIGILANCE COMMISSION ACT, 2003 | |
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| OBJECTIVE: | It is an Act to provide for the constitution of a Central Vigilance Commission to inquire or cause inquiries to be conducted into offences alleged to have been committed under the Prevention of Corruption Act, 1988 by certain categories of public servants of the Central Government, corporations established by or under any Central Act, Government companies, societies and local authorities owned or controlled by the Central Government and for matters connected therewith or incidental thereto. |
| COMPOSITION: | The CVC shall comprise of the Central Vigilance Commissioner acting as the Chairman, maximum two Vigilance Commissioners to be the members, members from the All India Services or Civil Service having special knowledge in the field of vigilance, policy framing and general administration including administration of police service. The President shall appoint the Chairman and the Vigilance Commissioners by warrant under his seal and hand , but according to the advice of the Committee. The term of office of the Commissioner shall be four years or until he attains the age of 65 years whichever is earlier. The Commissioner and other members shall be removed from his office by an order of the President if proved misbehavior or incapacity by the Supreme Court . The President shall also remove the Chairman and members on any of the following grounds: <ul style="list-style-type: none"> ➤ Declared insolvent. ➤ Condemned to be an offender which involves moral turpitude. ➤ Engaged in any employment for which he receives remuneration other than his official duties. ➤ Acquired financial interest which affects his function detrimental |

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| | to the duties as the Central Vigilance Commissioner or other members. |
| FUNCTION: | <ol style="list-style-type: none"> 1. The Commission shall supervise the functions of the Delhi Special Police Establishment in connection with the investigation and analysis of offence that comes under the Prevention of Corruption Act of 1988. 2. It issues directions and orders to the Delhi Special Police Establishment to discharge the functions assigned to it according to Delhi Special Police Establishment Act, 1946. 3. The Commission shall also inquire and review the developments of the complaints received against any officer for committing an offence under the Prevention of Corruption Act. 4. The Act empowers the Commission to provide guidance to the Central government or the corporations, Government companies or any local bodies on the subjects submitted to it. |

| LOKPAL AND LOKAYUKTA ACT, 2013 (THE LLA) | |
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| FORMATION: | The Parliament of India also enacted the LLA to constitute a Lokpal for the Union and Lokayukta for States to inquire into allegations of corruption against certain public functionaries. The LLA requires each State to establish a Lokayukta by law under the state legislature. |
| JURISDICTION: | The Lokpal has the jurisdiction to inquire into all complaints arising from the PCA against certain public functionaries, including an incumbent or past Prime Minister, an incumbent or past Union Minister and any person who is or has been a member of Parliament. |
| COMPOSITION: | <p>It consists of one Chairperson and a maximum of 8 members.</p> <p>Eligibility for chairman and members:</p> <ul style="list-style-type: none"> ➤ Former Chief Justice of India, a former member of Supreme Court. ➤ He should have adequate knowledge and 25 years of experience in the matters of the anticorruption policy, finance, vigilance, law and management, and public administration. ➤ Out of 8 permissible members, half will be coming from the judiciary. Rest 50% of members will be from OBC/ SC/ST/women and minorities Judicial members should either be a former Judge of Supreme Court or a former Chief Justice of a High Court. In the case of non-judicial members, they should be eminent persons with impeccable integrity and outstanding ability in their chosen professional areas. They should have at least of 25 years of experience in matters relating to anti-corruption policy, vigilance, public administration, vigilance, law, management, and finance. |
| LOKPAL WINGS: | According to the Lokpal and Lokayukta Act 2013, the anti-corruption ombudsman would constitute an inquiry wing under the Director of Enquiry. This wing would conduct the preliminary inquiry into an alleged |

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| | offense committed by a public servant. |
| LOKPAL BENCHES: | The Chairperson constitutes these benches as per his discretion. Ideally, each Lokpal bench will have two or more members. About 50% of the members in each Lokpal Bench should be judicial members. If the bench has the Chairperson, he will oversee it. In cases of benches that don't have the Chairperson, the judicial member will preside over them. The sitting of these benches may take place in New Delhi or any other place as decided by the Lokpal. |
| WORKING OF LOKPAL: | When citizens air their complaints, Lokpal receives them. Then, the anti-corruption ombudsman analyzes them to check their veracity. Once it decides to go ahead, Lokpal would order a preliminary inquiry. This would be done either by the inquiry wing or any other Central Government agency, such as Delhi Special Police Establishment, Central Bureau of Investigation (CBI), etc. The preliminary inquiry has to get completed within 90 days of receiving the complaint. However, the time of inquiry can be extended for further 90 days if the enquiring official requests in writing with sufficient reasons for it. |
| POWERS OF LOKPAL: | Its inquiry wing has the power to search and seize objects – both movable and immovable objects – and make reports based on them. These reports would be taken up by the 3-member Lokpal benches for further scrutiny. The benches would give the opportunities for the allegedly corrupt officers to say in their defense. After this, the benches would undertake any of the following alternatives. <ol style="list-style-type: none"> 1. If the officers are found guilty, the benches would grant their sanction to the prosecution wing or CBI to file charge sheets against them. The benches can also direct the concerned government departments to start proceedings against them. 2. If the officers are found innocent, the benches would direct the filing of the closure of case reports. |

| ICSI ANTI BRIBERY CODE | |
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| OBJECTIVES: | To ensure that neither the company nor any of its employees, directors or authorised representatives indulge in bribery in any of their actions taken for and on behalf of the company in the course of economic, financial or commercial activities of any kind. |
| SCOPE: | The Code shall be applicable to the company and its: <ul style="list-style-type: none"> ➤ Board of Directors, ➤ Employees (full time or part-time or employed through any third party contract), ➤ Agents, Associates, Consultants, Advisors, Representatives and Intermediaries, and ➤ Contractors, Sub-contractors and Suppliers of goods and/or services. |

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| Bribery | ‘Bribery’ includes giving or receiving bribe and third party gratification. The act of giving bribe is when committed intentionally in the course of economic, financial or commercial activities and when it is established that there is a promise, offering or giving, directly or indirectly, of an undue advantage to any person who directs or works, in any capacity, for a commercial entity, for the person himself or for another person, in order that he in breach of his duties, act or refrain from acting . |
| ‘Facilitation payment’ | ‘Facilitation payment’ means a payment made to government or private official that acts as an incentive for the official to complete some action or process expeditiously to the benefit of the party making the payment. |
| ‘Foreign public official’ | ‘Foreign public official’ means any person holding a legislative, executive, administrative or judicial office of a foreign country, whether appointed or elected , whether permanent or temporary, whether paid or unpaid and includes a person who performs a public function or provides service for a foreign country |
| CLAUSES: | Clause 1: Adherence to Anti-Corruption Laws . Clause 2: Bribery in Private Sector Clause 3: Facilitation Payments. Clause 4: Bribery to Foreign Public Officials Clause 5: Policy for Gifts, Hospitality & Expenses. Clause 6: Whistle Blower Mechanism. Clause 7: Anti- Bribery Training and Awareness Programmes. Clause 8: Monitoring Mechanism for Anti-Bribery Code . Clause 9: Sanctions for Non-compliance |
| Guiding Instructions for Implementation of the Code: | <ol style="list-style-type: none"> 1. Corporate Anti-Bribery Code is to be adopted voluntarily. 2. The Code shall be approved by the Board of Directors of the company. Any change in the Code shall be made with the approval of the Board of the Company. 3. The Code shall be communicated to all existing employees, management and Board members. 4. All the existing employees, management and Board members shall confirm in writing that they shall unconditionally follow the Code in its entirety throughout their employment/association with the company. 5. All the new appointees shall be required to confirm in writing, at the time of their induction in the company that they shall be bound by the Code. 6. All agents, associates, consultants, advisors, all the contractors, sub-contracts and suppliers of goods and/or services, representatives and intermediaries engaged by the company shall also be required to follow the Code while carrying on their assignments for and on behalf of the company at any time during their association with the company. It shall also be made a mandatory condition while confirming their appointment. 7. Anti-Bribery Code of the company shall be put on company’s website. Any change in the Code shall be immediately updated. |

8. With a view to facilitate the companies, the following model suggested policies which may be adopted by the Board of Directors of the company are annexed to the Code:

- **Model Policy on Gifts, Hospitality & Expenses.**
- **Model Policy on Purchase through Supplier and other Service Provider.**
- **Guidelines for Whistle Blower Policy.**

SOME EXAMINATION QUESTIONS

1. Enumerate the laws and enforcement regimes behind Anti-Corruption and Anti-Bribery Laws in India.
2. Brief description of the Prevention of Corruption, 1988.
3. What is the composition of the Lokpal?
4. What are the grounds basis which the President can remove the Chairman and members on the board under Central Vigilance Commission Act, 2003?
5. What is the scope of Anti Bribery code as applicable by the ICSI?
6. Liability of individual directors and officers under Prevention of Corruption Act, 1988.
7. Define the following terms; – Bribery – Facilitation payment – Foreign public official

