Corporate Governance Voluntary Guidelines 2009- thrust on voluntary adoption of laws for achieving good governance standards

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Good Corporate Governance is a sine qua non for Corporate India and its sustenance. Business entities are mandatorily required to follow certain governance practices by virtue of Act, rules and regulations which are administered by the Ministry of Corporate Affairs, SEBI and other regulatory authorities. In spite of these regulations, there are instances of corporate frauds and failures, which indicate that a transparent, ethical and responsible corporate governance framework stem from the intrinsic will of the business entity for good corporate governance.

With the Satyam episode in India and hundreds all over the world, the focus of Corporate India rightly shifts to corporate governance. Smartly enough, before the regulators act, Task Force of Confederation of Indian Industry (CII) under the Chairmanship of Sri Naresh Chandra published its own code of corporate governance for voluntary adoption by all the listed companies and its wholly owned subsidiaries. The Institute of Company Secretaries of India also issued its recommendations for strengthening corporate governance framework. The current Guideline issued by the Ministry is a blend of the recommendations of the Task Force, that of the ICSI and the feedback received therefor.

While the CII also emphasized on the role of regulatory agencies and external institutions for ethical and responsible conduct of business, the Ministry's Guideline is centered round the organization structure.

The Guidelines have 6 major aspects:

- Board of Directors
- Responsibilities of the Board
- Audit Committee of Board
- Auditors
- Secretarial Audit
- Institution of Mechanism for Whistle Blowing

Each of the above elements is explained briefly hereinbelow:

Board of Directors

- Appointment of Directors
    - **Appointments to the Board**

    - Companies should issue formal letters of appointment to the Non-Executive Directors (ED) and Independent Directors (ID) which shall specify their terms of appointment, duties, remuneration etc.
    - Such formal letter should form part of disclosure to the shareholders at the time of ratification of his/her appointment and/or re-appointment.

  This aspect has been taken from the recommendations of the CII.

- **Separation of Offices of Chairman & Chief Executive Officer**

  To prevent unfettered decision making power with a single individual, there should be a clear demarcation of the roles and responsibilities of the Chairman of the Board and that of the Managing Director (MD)/Chief Executive Officer (CEO).

  Both CII and ICSI has emphasized on the need for separation of office of Chairman & CEO.

- **Nomination Committee**
    - The companies may have a Nomination Committee comprising of majority of Independent Directors, including its Chairman for considering proposals for searching, evaluating, and recommending appropriate Independent Directors and Non-Executive Directors
    - Nomination Committee should ensure that the Board comprises of a balanced combination of ED and NED
    - The Nomination Committee should also evaluate and recommend the appointment of ED.
    - The Annual Report should disclose the guidelines being followed by the Nomination Committee and the role and work done during the year under consideration.

  Both CII and ICSI has provide for formation of Nomination Committee.

- **Number of Companies in which an Individual may become a Director**
    - For reckoning maximum number of directorship, public companies and companies which are holding or subsidiary of public companies should be included
    - The maximum number of companies where a MD or WTD of a company can serve as NED or ID should be restricted to seven.

  This aspect has been taken from the recommendations of the ICSI.

- **Independent Directors**
  - **Attributes for Independent Directors**
    - The Board should put in place a policy for specifying positive attributes of Independent Directors such as integrity, experience and

expertise, foresight, managerial qualities and ability to read and understand financial statements.
    - All Independent Directors should provide a detailed Certificate of Independence at the time of their appointment, and thereafter annually.
    - This certificate should be displayed on the website of the company, if any, and in case of listed company, also on the website of the stock exchange where the securities of the company are listed.

  The CII report provides for Certificate of Independence from auditors certifying the firm's independence and arm length relationship with the client company. The Ministry has extended the requirement for the Independent Directors also.

  - **Tenure for Independent Director**
    - Tenure of independent director in a company not more than Six years
    - A gap of Three years between two successive appointments
    - Only three such tenures for one company
    - Maximum number of companies in which one can serve as ID at a time should be restricted to seven

  - **Independent Directors to have the Option and Freedom to meet Company Management periodically**
    - ID should have option and freedom to interact with company management periodically
    - They should be provided with adequate independent office space and resources

- **Remuneration to Directors**
  - **Remuneration**
    - Guiding Principles-Linking Corporate and Individual Performance
    - Remuneration of Non-Executive Directors (NEDs): The companies should have an option of giving a fixed contractual remuneration to NEDs, not linked with profits, which should be uniform for all NEDs.
    - Structure of Compensation to NEDs- Companies may structure the remuneration to NEDs into (a) fixed component, (b) variable component and (c) additional variable component
    - Remuneration of Independent Directors (IDs) - Adequate sitting fees to be paid to ID which may depend upon twin criteria of net worth and turnover of companies
  - **Remuneration Committee**
    - Remuneration Committee should comprise of at least three members, majority of whom should be NEDs with at least one being an Independent Director.
    - Responsibility – to determine the remuneration for all EDs and the executive chairman,

- The Committee should also determine principles, criteria and the basis of remuneration policy of the company which should be disclosed to shareholders and their comments, if any, considered suitably.
- The Committee should also recommend and monitor the level and structure of pay for senior management.
- The terms of reference, role, authority delegated to the Committee by the Board, and work of Committee for the year under review shall be disclosed in the Annual Report.

Both CII and ICSI has emphasized on the need for balance between fixed and variable component in director's remuneration and forming Remuneration Committee to evaluate director's performance and review remuneration policy of the company.

Responsibilities of the Board

- Training of Directors
- Enabling Quality Decision making
- Risk Management
- Evaluation of Performance of Board of Directors, Committees thereof and of Individual Directors
- Board to place Systems to ensure Compliance with Laws

The ICSI in its report has recommended for induction training of directors and other training program for enhancing their skills.

Audit Committee of the Board

- **Constitution**
    - Three-member Audit Committee, with Independent Directors constituting the majority. The Chairman of such Committee should be an Independent Director.

- **Enabling Powers:**
    - Independent back office support and other resources from the company
    - Access to information contained in the records of the company; and
    - Obtain professional advice from external sources.
    - Facility of separate discussions with both internal and external auditors as well as the management.

- **Role and Responsibilities**
    - Monitor the integrity of the financial statements of the company;
    - Review the company's internal financial controls, internal audit function and risk management systems;

- Make recommendations in relation to the appointment, reappointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
- Monitor and approve all Related Party Transactions

Auditors

- **Appointment of Auditors**
  - The Audit Committee of the Board should be the first point of reference regarding the appointment of auditors.
  - The Audit Committee should consider the profile of the audit firm, qualifications and experience of audit partners, strengths and weaknesses, if any, of the audit firm and other related aspects in this respect.
  - The Audit Committee should discuss the audit plan to be undertaken by the auditor, with the auditor; examine and review the certificate for proof of independence of the audit firm, and recommend to the Board, with reasons, either the appointment/re-appointment or removal of the statutory auditor, along with the annual audit remuneration.

- **Certificate of Independence**
  - Every company should obtain a certificate from the auditor certifying his/its independence and arm's length relationship with the client company.

- **Rotation of Audit Partners and Firms**
  - To maintain independence of auditors, the company must adopt a policy of rotation of auditors in the following manner:
    - Audit partner - to be rotated once every three years
    - Audit firm - to be rotated once every five years.
  - A cooling period between two audit assignment

- **Need for clarity on information to be sought by auditor and/or provided by the company to him/it**

- **Appointment of Internal Auditor**

  - The Board may appoint an internal auditor and such auditor, where appointed, should not be an employee of the company.

Both CII and ICSI have made elaborate provisions in respect of rotation of auditors firm and partners. The CII has emphasized the need for constitution of Audit Committee, their independence, roles and responsibilities.

Secretarial Audit

To ensure that the Board processes and compliance mechanisms of the company are robust, the companies may get the Secretarial Audit conducted by a competent professional. The Board should give its comments on the Secretarial Audit in its report to the shareholders.

The ICSI has, in its report recommended Secretarial Audit to be made mandatory in respect of listed and certain other companies.

Institution of mechanism for Whistle Blowing

The companies should ensure the institution of a mechanism for employees to report concerns about unethical behaviour, actual or suspected fraud, or violation of the company's code of conduct or ethics policy.

The companies should also provide for adequate safeguards against victimization of employees who avail of the mechanism.

Both CII and ICSI have emphasized on the need for putting in place an effective whistle blower policy within the organization.

For full text of the Guidelines, click on http://www.mca.gov.in/Ministry/latestnews/CG_Voluntary_Guidelines_2009_24dec2009.pdf