SEBI had constituted a Committee on Corporate Governance under the Chairmanship of Shri N. R. Narayana Murthy. Based on the recommendations of the Committee and public comments received, certain amendments were made in Clause 49 of the Listing Agreement, vide circular dated August 26, 2003.

SEBI convened another meeting of the Narayana Murthy committee on Corporate Governance be convened on November 17, 2003 for deliberating the suggestions and representations received after the issuance of the aforesaid circular.

The committee has since submitted its report to SEBI. The report proposes certain amendments in the revised clause 49 which was issued vide circular dated 26th August 2003. The report is reproduced below for seeking public comments.

Issues under clause 49 and proposed amendments

Issue 1 – Definition of independent director

Existing language – Explanation (i)(e) to clause I.A

Explanation (i): For the purpose of this clause, the expression 'independent director' shall mean non-executive director of the company who:

a. apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;

b. is not related to promoters or management at the board level or at one level below the board;

c. has not been an executive of the company in the immediately preceding three financial years;

d. is not a partner or an executive of the statutory audit firm or the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.

e. is not a supplier, service provider or customer of the company. This should include lessor-lessee type relationships also; and

f. is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares.

Discussion

Explanation (i)(e) restricts any supplier, service provider or customer of the company from being an independent director on the board of the company. This clause should ideally only bar persons who are **material** suppliers, service providers or customers and not extend it to any and all suppliers, service providers or customers.

This view is further supported by the fact that Explanation (i)(a) does not disqualify a non-executive director who has an *immaterial* pecuniary relationship or transaction with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies from serving as an independent director.

It is therefore proposed that the word "material" be inserted before supplier, in Explanation (i)(e) to Clause I.A.

Revised language – Explanation (i)(e) to clause I.A

Explanation (i): For the purpose of this clause, the expression 'independent director' shall mean non-executive director of the company who:

a. apart from receiving director's remuneration, does not have, in the opinion of the board, any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies which in the judgment of the board may affect independence of judgment of the director;

b. is not related to promoters or management at the board level or at one level below the board;

c. has not been an executive of the company in the immediately preceding three financial years;

d. is not a partner or an executive of the statutory audit firm or the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.

e. is not, in the opinion of the board, a material supplier, service provider or customer of the company, which in the judgment of the board may affect independence of judgment of the director". This should include lessor-lessee type relationships also; and

f. is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares.

Note:

For the purposes of this clause:

a. Associated company shall mean a company which is an "associate" as defined in Accounting Standard (AS) 23, "Accounting for Investments in Associates in Consolidated Financial Statements", issued by the Institute of Chartered Accountants of India.

b. Senior management shall have the meaning as prescribed in the explanation to clause VII (E).

c. "Relative" shall mean "relative" as defined in section 2(41) and section 6 of the Companies Act, 1956.

Issue 2 – Definition of independent director – "Institutional directors"

Existing language – Explanation (ii) to clause IA

Explanation (ii) : Institutional directors on the boards of companies shall be considered as independent directors whether the institution is an investing institution or a lending institution.

Discussion

a. The explanation does not make it clear that even an institutional director must in order to be considered as independent, satisfy the tests laid down in clauses (a) to (f).

b. It is also necessary to clarify that institutional directors have the same rights, duties and responsibilities as any other member of the board.

Revised language – Explanation (ii) to clause IA

a. There shall be no nominee directors. Where an institution wishes to appoint a director on the Board, such appointment should be made by the shareholders.

b. An institutional director on the boards of companies shall be considered as an independent director unless he does not satisfy the requirements of any of the clauses (a) to (f) listed above.

c. An institutional director shall have the same rights, duties and responsibilities as other members of the board and as prescribed under the Companies Act, 1956 and the Listing regulations.

d. Nominee of the Government on public sector companies shall be similarly elected

and shall be subject to the same responsibilities and liabilities as other directors.

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Issue 3 – Remuneration paid to non-executive directors

Existing language – Clauses I.B(i), I.B(ii) and I.C(ii)

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

Clauses I.B(ii) and I.C(ii) – The considerations as regards remuneration paid to an independent director shall be the same as those applied to a non-executive director

Discussion

It is recommended that a clarification be added to state that non-executive directors include independent director. This will ensure clarity in drafting.

As a result of this, clauses I.B(ii) and I.C(ii) become redundant and should be deleted.

Revised language – Clauses I.B(i), I.B(ii) and I.C(ii)

49 I.B(i) All remuneration paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall be agreed to by shareholders in general meeting. Limits shall be set for the maximum number of stock options that can be granted to non-executive directors, including independent directors, in any financial year and in aggregate. The stock options granted to the non-executive directors, including independent directors, shall vest after a period of at least one year from the date of grant of the stock options. This requirement shall apply prospectively to all new option grants made after the effective date of this circular.

Delete clauses I.B(ii) and I.C(ii)

Issue 4 – Responsibility of independent directors

Existing language – Clause I.C(i)

> I.C(i) Independent director shall however periodically review legal compliance reports prepared by the company as well as steps taken by the company to cure any taint. In the event of any proceedings against an independent director in connection with the affairs of the company, defence shall not be permitted on the ground that the independent director was unaware of this responsibility.

Discussion

The board as a whole should have the responsibility to periodically review legal compliance reports prepared by the company as well as the steps taken to cure any instances of non-compliance.

A director is an officer of the company and the term "officer who is in default" has already been defined in section 2(31) and section 5 of the Companies Act, 1956. It is therefore not necessary to make any further provision in this respect and the second sentence to clause I(C)(i) may be deleted.

Revised language – Clause I.C(i)

> 49 I C(i) The Board shall periodically review legal compliance reports prepared by the company as well as steps taken by the company to cure instances of non-compliances.

Issue 5 – Amendment to board procedures

Existing language – Clause I.D(iii)

> I.D(iii) Further only the three committees viz. the Audit Committee, the Shareholders' Grievance Committee and the Remuneration Committee shall be considered for this purpose.

Discussion

There is currently a shortage of independent directors. The Companies Act, 1956 prescribes in section 277 that a person cannot hold more than 15 directorships and section 278 provides that in considering the limit, directorship as an alternate director should be excluded, whereas the clause restricts committee memberships to 10. Therefore, independent directors who would otherwise be willing to serve on such committees are unable to do so.

The formation of a remuneration committee is not mandatory and it meets only occasionally. It is therefore suggested that for the purposes of the calculation of the limit, only the audit committee and the shareholders' grievance committee should be counted.

Revised language – Clause I.D(iii)

> I.D(iii) Further only two committees viz. the Audit Committee and the Shareholders' Grievance Committee shall be considered for this purpose.

Issue 6 – Term of office of non-executive directors

Existing language – Clause I.F(i)

> I.F(i) Person shall be eligible for the office of non-executive director so long as the term of office did not exceed nine years in three terms of three years each, running continuously.

Discussion

The existing language in clause I.F(i) would require that no non-whole time director can continue as a director beyond a period of three consecutive terms of three years each, i.e. a total of nine years. This may create practical problems as it may prevent promoters and directors protecting their interests from continuing on the board even while the promoters' investment in the company continues. It may also prevent the continuance on the board of other individuals, who may be making a significant contribution as a board member and whose continuance on the board may be in the interest of the company.

It can however be argued that long association with the company may be perceived as impairing the independence of a director. It may therefore be provided that where an individual continues on the board beyond the prescribed term of nine years, he shall no longer be considered as an independent director.

It is also necessary that this provision be made prospective, i.e. it should apply to a period of nine years in

the aggregate, such period to commence on or after the date the amended clause 49 comes into force. It is therefore necessary that this clause be amended as follows:

Revised language – Clause I.F(i)

> I.F(i) A director shall be considered to be an independent director only so long as his tenure on the board does not exceed, in the aggregate, a period of nine years, such period to be considered as commencing on or after the date this circular comes into force or the date of his first appointment as a director, whichever is later. After the expiry of the said period, the director may continue to be a member of the board and be eligible for reappointment on the expiry of his term, but he shall not be considered to be an independent director.

Issue 7 – Requirements related to audit committees

Existing language –Clause II.A(iv)

> II.A(iv) The Chairman shall be present at Annual General Meeting to answer shareholder queries

Discussion

It may not be practical for the Chairman of the Audit Committee to be present at all annual general meetings to answer shareholder queries due to various reasons, including travel, ill health, etc. it is therefore recommended that in his absence, another member of the audit committee, who is an independent director may be present to answer shareholder queries.

Revised language –Clause II.A(iv)

> II.A(iv) The Chairman of the audit committee, or in his absence, a designated member of the audit committee who is an independent director shall be present at Annual General Meeting to answer shareholder queries

Issue 8 – Meeting of Audit Committee – Clause II.B

Existing language

> II.B The audit committee shall meet at least thrice a year. One meeting shall be held before finalization of annual accounts and one every six months. The quorum shall be either two members or one third of the members of the audit committee, whichever is higher and minimum of two independent directors.

Discussion

Clause II.D(i) requires that the audit committee should have an oversight of the disclosure of financial information. A listed company is required to publish quarterly financial results and annual financial statements. It is therefore necessary that the audit committee should meet at least four times in a year.

Revised language

> II.B The audit committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

Issue 9 – Role of the audit committee

Existing language –Clause II.D

(i) The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

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

3. Reviewing with management the annual financial statements before submission to the board, focusing primarily on;

    a. Any changes in accounting policies and practices.

    b. Major accounting entries based on exercise of judgment by management.

    c. Qualifications in draft audit report.

    d. Significant adjustments arising out of audit.

    e. The going concern assumption.

    f. Compliance with accounting standards.

    g. Compliance with stock exchange and legal requirements concerning financial statements

    h. Any related party transactions

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

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

6. Discussion with internal auditors any significant findings and follow up there on.

7. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.

8. Discussion with external auditors before the audit commences about nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

9. Reviewing the company's financial and risk management policies.

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

> **Explanation (i):** The term "related party transactions" shall have the same meaning as contained in the Accounting Standard 18, Related Party Transactions, issued by The Institute of Chartered Accountants of India.
>
> **Explanation (ii):** If the company has set up an audit committee pursuant to provision of the Companies Act, the company agrees that the said audit committee shall have such additional functions / features as is contained in the Listing Agreement.

Discussion

Section 217(2AA) of the Companies Act, 1956 requires that the Board's report should include a Director's Responsibility Statement which covers many of the items covered in this clause. To ensure consistency, it is necessary to reword some of the clauses.

Revised language –Clause II.D

(i) The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the external auditor and the fixation of audit fees.

3. Approval of payment to external auditors for any other services rendered by the external auditors.

4. Reviewing, with the management, the annual financial statements before submission to the board for approval, with particular reference to:

    a. Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause 2AA of section 217 of the Companies Act, 1956

    b. Changes, if any, in accounting policies and practices and reasons for the same

    c. Major accounting entries involving estimates based on the exercise of judgment by management

    d. Significant adjustments made in the financial statements arising out of audit findings

    e. Compliance with listing and other legal requirements relating to financial statements

    f. Disclosure of any related party transactions

    g. Qualifications in the draft audit report.

5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval

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

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

8. Discussion with internal auditors any significant findings and follow up there on.

9. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.

10. Discussion with external auditors before the audit commences about nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

11. Reviewing the company's financial and risk management policies.

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

Explanation (i): The term "related party transactions" shall have the same

meaning as contained in the Accounting Standard 18, Related Party Transactions, issued by The Institute of Chartered Accountants of India.

Explanation (ii): If the company has set up an audit committee pursuant to provision of the Companies Act, the company agrees that the said audit committee shall have such additional functions / features as is contained in the Listing Agreement.

Clause II.E.5 becomes redundant and should therefore be deleted.

Issue 10 – Review of information by Audit Committee

Existing language –Clause II.E

(E) Review of information by Audit Committee

(i) The Audit Committee shall mandatorily review the following information:

1. Financial statements and draft audit report, including quarterly / half-yearly financial information;
2. Management discussion and analysis of financial condition and results of operations;
3. Reports relating to compliance with laws and to risk management;
4. Management letters / letters of internal control weaknesses issued by statutory / internal auditors; and
5. Records of related party transactions
6. The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee

Discussion

The requirement in sub-clause 1 is already covered in clause I.D and should be deleted

It is not practical to expect audit committees to review the records of related party transactions. It should be sufficient if management places before the audit committee for review, a statement of significant related party transactions and gives details of related party transactions that are not at an arm's length basis with reasons for the same.

Clause VII provides that risk management procedures should be reviewed by the Board. Therefore, there is no need for the audit committee to also perform this review.

Revised language –Clause II.E

II (E) Review of information by Audit Committee

(i) The Audit Committee shall mandatorily review the following information:

1. Management discussion and analysis of financial condition and results of operations;
2. Statement of significant related party transactions (as defined by the audit committee), submitted by management;
3. Management letters / letters of internal control weaknesses issued by the external auditors;

4. Internal audit reports relating to internal control weaknesses; and

5. The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

Issue 11 – Audit reports and qualifications

Existing language –Clause III.A

A. Disclosure of Accounting Treatment

In case it has followed a treatment different from that prescribed in an Accounting Standards, management shall justify why they believe such alternative treatment is more representative of the underlined business transactions. Management shall also clearly explain the alternative accounting treatment in the footnote of financial statements.

Discussion

Where an accounting standard is not followed, the auditor is required to disclose that fact and qualify his report. What is proposed, in addition, is that management should provide an explanation in a note to the financial statements as to the fact that an accounting standard is not followed and the reason for the departure. The language in the clause does not bring this out.

Since this is a matter of disclosure, it would be more appropriate to delete this clause and include an amended clause under clause VII as sub-clause (AA)

Revised language –Clause VII.AA

AA. Disclosure of Accounting Treatment

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

Issue 12 – Whistle Blower Policy

Existing language –Clause IV.A

(A) Internal Policy on access to Audit Committees:

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

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

iii. Company shall annually affirm that it has not denied any personnel access to the audit committee of the company (in respect of matters involving alleged misconduct) and that it has provided protection to "whistle blowers" from unfair termination and other unfair or prejudicial employment practices.

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

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

Discussion

The intention of this clause is that management establishes 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 exact details of such a mechanism should be left to each company, through its Board of Directors, to decide but the existence and implementation must be reviewed by the audit committee. The mechanism must have adequate provisions to ensure there is no victimization of employees who avail of this procedure. The clause may be reworded accordingly.

Revised language – Clause IV.A

i. The company will establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy.

ii. The mechanism must provide for adequate safeguards against victimization of employees who avail of the mechanism.

iii. The mechanism must also provide, where senior management is involved, direct access to the Chairman of the Audit Committee.

iv. The existence of the mechanism must be appropriately communicated within the organization.

v. The Audit Committee must periodically review the existence and functioning of the mechanism.

Issue 13 – Deletion of redundant clause on internal audit

Existing language –Clause IV.A(v)

IV.A(v) The appointment, removal and terms of remuneration of the chief internal auditor shall be subject to review by the Audit Committee.

Discussion

Clause IV.A(v) dealing with the audit committee review of the appointment, removal and terms of remuneration of the Chief Internal Auditor should be deleted since this is a repetition of clause II.E.6 of clause 49. This ensures absence of redundant language.

Revised language –Clause IV.A(v)

Clause IV.A(v) should be deleted.

Issue 14 – Subsidiary companies

Existing language –Clause V

i. The company agrees that provisions relating to the composition of the Board of Directors of the holding company shall be made applicable to the composition of the Board of Directors of subsidiary companies

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

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

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

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

Discussion

It has been pointed out that the implementation of this clause may create the following practical difficulties:

1. Subsidiaries are often of small size and it may be too onerous if all the provisions regarding the composition of the board as applicable to a holding company are made applicable to every subsidiary. There may also be difficulties in applying this clause to joint ventures, when the composition of the board may be determined by the joint venture agreement.

2. Where there are a large number of subsidiaries, independent directors on the board of the parent company may not be willing to become directors on the board of a subsidiary, particularly where such a directorship is included in the number of directorships to which the ceiling prescribed under the Companies Act, 1956 applies.

3. It may be very expensive for a company if the independent director is required to attend board meetings of foreign subsidiaries

   At the same time, it needs to be appreciated that the intention in formulating this clause was the need for the board of the holding company to have some independent link with the board of the subsidiary and provide necessary oversight.

   It is therefore suggested that the clause may be revised as under:

   1. The provisions of sub-clause (ii), which provide that at least one independent director in the holding company shall be a director of the subsidiary company shall apply only to material Indian subsidiaries i.e. subsidiaries whose turnover or net worth in the immediately preceding year exceeds 20% of the consolidated turnover or consolidated net worth respectively, of the holding company and its subsidiaries.

   2. There should be an obligation on the part of the management to bring to the attention of the board of the holding company significant transactions and arrangements entered into by the subsidiary companies. For this purpose, "significant transaction and arrangement" shall mean any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities of the company, as the case may be, in the immediately preceding year.

Clause V (v) pertaining to a disclosure of the review of affairs of a subsidiary company by the board of the parent company should be deleted since it is superfluous. This aspect is already covered in clauses V (iii) and V(iv).

Revised language –Clause V

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

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

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

Explanation (i): The term "material non-listed Indian subsidiary" shall mean an unlisted

subsidiary, incorporated in India, whose turnover or net worth (i.e. paid up capital and free reserves) in the preceding accounting year exceeds 20% of the consolidated turnover or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

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

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

Issue 15 – Disclosure of contingent liabilities

Existing language –Clause VI

VI(i) The company agrees that management shall provide a clear description in plain English of each material contingent liability and its risks, which shall be accompanied by the auditor's clearly worded comments on the management's view. This section shall be highlighted in the significant accounting policies and notes on accounts, as well as, in the auditor's report, where necessary.

Discussion

The disclosure of contingent liabilities is already required under Schedule VI to the Companies Act, 1956. It is also impractical for auditors to comment on management's views and any such view/comment may be construed as an admission of the liability, which may be detrimental to the interests of the shareholders. It is therefore suggested that this clause be deleted.

Revised language –Clause VI

Delete clause VI(i) in its entirety.

Issue 16 – Basis of related party transactions

Existing language –Clause VII.A(i)

VII.A(i) A statement of all transactions with related parties including their basis shall be placed before the Audit Committee for formal approval/ratification. If any transaction is not on an arm's length basis, management shall provide an explanation to the Audit Committee justifying the same.

Discussion

It may be cumbersome and unnecessary for the audit committee to review all transactions with related parties which are in the ordinary course of business. It should therefore be sufficient if these transactions are placed periodically in a summary form before the audit committee.

It is however necessary that material individual transactions which are not in the normal course of business are placed before the audit committee. It is also necessary that management identify and place before the audit committee, material individual transactions, whether in the normal course of business or otherwise, with related parties or others which are not on an arm's length basis, together with a justification for the same.

Revised language –Clause VII.A(i)

VII.A(i) A statement in summary form of transactions with related parties in the ordinary

course of business shall be placed periodically before the audit committee.

(ii) Material individual transactions with related parties which are not in the normal course of business shall be placed before the audit committee.

(iii) Material individual transactions with related parties or others which are not on an arm's length basis should be placed before the audit committee, together with Management's justification for the same.

Issue 17 – Board disclosures – risk management

Existing language –Clause VII.B(i)

VII.B(i) Management shall place a report certified by the compliance officer of the company, before the entire Board of Directors every quarter documenting the business risks faced by the company, measures to address and minimize such risks, and any limitations to the risk taking capacity of the corporation. This document shall be formally approved by the Board.

Discussion

The compliance officer of a company may not be the right person to attest/certify disclosure of the business risks faced by a company. It is recommended that this requirement be deleted.

Revised language –Clause VII.B(i)

Delete clause VII.B(i) in its entirety.

Issue 18 – Proceeds from Initial Public Offering (IPO)

Existing language –Clause VII.C(i)

VII.C(i) When money is raised through an Initial Public Offering (IPO) it shall disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus. This statement shall be certified by the independent auditors of the company. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

Discussion

The current language in clause 49 requires companies to disclose use of IPO proceeds without specifying any time limitation. It is recommended that clause 49 be amended to ensure this disclosure is required only till funds are spent. There is no reason why this provision should apply only to an IPO and not be made applicable to all public offerings.

Further, funds utilised for purposes other than that for which they were raised should be placed before the audit committee.

Revised language –Clause VII.C(i)

When money is raised through an issue to public (including public issues, rights issues), it shall disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus and place it before the audit committee. Such disclosure shall be made only till such time that the full money raised through the issue has been fully

spent. This statement shall be certified by the statutory auditors of the company. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

Issue 19 – Remuneration of directors

Existing language –Clause VII.D(ii)(a)

> VII.D(ii)(a) All elements of remuneration package of all the directors, i.e. salary, benefits, bonuses, stock options, pension etc.

Discussion

It is recommended that the disclosure of remuneration provided to directors should be aggregated by major category and disclosed. This will facilitate a robust disclosure of director's remuneration.

Revised language –Clause VII.D(ii)(a)

> VII.D(ii)(a) All elements of remuneration package of individual directors**, summarized under major groups, such as** salary, benefits, bonuses, stock options, pension etc.

Issue 20 – Management

Existing language –Clause VII.E(i)

> VIII.E(i) Management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)

Discussion

Clause VII.E requires management to disclose to the board details of transactions where they have personal interests. It is recommended to change "Management" to "Senior management" as follows, to make the language tighter and more precise.

Revised language –Clause VII.E(i)

> VII.E(i) **Senior** management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)
>
> **Explanation: For this purpose, the term "senior management" shall mean personnel of the company who are members of its management / operating council (i.e. core management team excluding independent directors). This would also include all members of management one level below the executive directors**

Issue 21 – CEO/CFO certification

Discussion

> (a) The CEO and the CFO must assume primary responsibility for ensuring that the company does not enter into transactions which are fraudulent, illegal or violative of the company's code of conduct or ethics policy.

i. Clause (f) which deals with two separate matters viz. (i) internal control and (ii) accounting policies should be split into two clauses as changes an internal control cannot be disclosed in the notes to the financial statements.

Revised language – CEO/CFO certification

The CEO (either the Executive Chairman or the Managing Director or Manager) and the CFO (either the whole-time Finance Director or any other person heading the Finance function) discharging that function shall certify to the Board that:

a. They have reviewed financial statements and the cash flow statement and the Directors' Report and that to the best of their knowledge and belief :

   i. these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;

   ii. 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 which are fraudulent, illegal or violative of the company's code of conduct or ethics policy.

c. They accept responsibility for establishing and maintaining internal controls and that they have evaluated the effectiveness of the internal control systems of the company and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of 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

   i. significant changes in internal control during the year;

   ii. significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and

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

Issue 22 – Annexure 1C – 4. Postal Ballot

With effect from June 15, 2001, section 192A was introduced in the Companies Act, 1956 providing for the passing of resolutions by postal ballot. Since this is now part of law, it is suggested that paragraph 4 of Annexure 1C be deleted.

SEBI convened deliberating theafter the issuance of the aforesaid circular. SEBI hosted aforesaid in its The commentsin its meeting held on

The committee has since submitted its report to SEBI. The report is reproduced below for seeking public comments.*****

Issues under clause 49 and proposed amendments

Issue 1 – Definition of independent director

Existing language – Explanation (i)(e) to clause I.A

Explanation (i): For the purpose of this clause, the expression 'independent director' shall mean non-executive director of the company who:

a. apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;

b. is not related to promoters or management at the board level or at one level below the board;

c. has not been an executive of the company in the immediately preceding three financial years;

d. is not a partner or an executive of the statutory audit firm or the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.

e. is not a supplier, service provider or customer of the company. This should include lessor-lessee type relationships also; and

f. is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares.

Discussion

Explanation (i)(e) restricts any supplier, service provider or customer of the company from being an independent director on the board of the company. This clause should ideally only bar persons who are **material** suppliers, service providers or customers and not extend it to any and all suppliers, service providers or customers.

This view is further supported by the fact that Explanation (i)(a) does not disqualify a non-executive director who has an *immaterial* pecuniary relationship or transaction with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies from serving as an independent director.

It is therefore proposed that the word "material" be inserted before supplier, in Explanation (i)(e) to Clause I.A.

Revised language – Explanation (i)(e) to clause I.A

Explanation (i): For the purpose of this clause, the expression 'independent director' shall mean non-executive director of the company who:

a. apart from receiving director's remuneration, does not have, in the opinion of the board, any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies <u>which in the judgment of the board may affect independence of judgment of the director</u>;

b. is not related to promoters or management at the board level or at one level below the board;

c. has not been an executive of the company in the immediately preceding three financial years;

d. is not a partner or an executive of the statutory audit firm or the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.

e. is not, in the opinion of the board, a <u>material</u> supplier, service provider or customer of the company, which in the judgment of the board may affect independence of judgment of the director". This should include lessor-lessee type relationships also; and

f. is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares.

Note:

For the purposes of this clause:

a. Associated company shall mean a company which is an "associate" as defined in Accounting Standard (AS) 23, "Accounting for Investments in Associates in Consolidated Financial Statements", issued by the Institute of Chartered Accountants of India.

b. Senior management shall have the meaning as prescribed in the explanation to clause VII (E).

c. "Relative" shall mean "relative" as defined in section 2(41) and section 6 of the Companies Act, 1956.

Issue 2 – Definition of independent director – "Institutional directors"

Existing language – Explanation (ii) to clause IA

Explanation (ii) : Institutional directors on the boards of companies shall be considered as independent directors whether the institution is an investing institution or a lending institution.

Discussion

a. The explanation does not make it clear that even an institutional director must in order to be considered as independent, satisfy the tests laid down in clauses (a) to (f).

b. It is also necessary to clarify that institutional directors have the same rights, duties and responsibilities as any other member of the board.

Revised language – Explanation (ii) to clause IA

a. There shall be no nominee directors. Where an institution wishes to appoint a director on the Board, such appointment should be made by the shareholders.

b. An institutional director on the boards of companies shall be considered as an independent director unless he does not satisfy the requirements of any of the clauses (a) to (f) listed above.

c. An institutional director shall have the same rights, duties and responsibilities as other members of the board and as prescribed under the Companies Act, 1956 and the Listing regulations.

d. Nominee of the Government on public sector companies shall be similarly elected

and shall be subject to the same responsibilities and liabilities as other directors.

Issue 3 – Remuneration paid to non-executive directors

Existing language – Clauses I.B(i), I.B(ii) and I.C(ii)

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

Clauses I.B(ii) and I.C(ii) – The considerations as regards remuneration paid to an independent director shall be the same as those applied to a non-executive director

Discussion

It is recommended that a clarification be added to state that non-executive directors include independent director. This will ensure clarity in drafting.

As a result of this, clauses I.B(ii) and I.C(ii) become redundant and should be deleted.

Revised language – Clauses I.B(i), I.B(ii) and I.C(ii)

49 I.B(i) All remuneration paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall be agreed to by shareholders in general meeting. Limits shall be set for the maximum number of stock options that can be granted to non-executive directors, including independent directors, in any financial year and in aggregate. The stock options granted to the non-executive directors, including independent directors, shall vest after a period of at least one year from the date of grant of the stock options. This requirement shall apply prospectively to all new option grants made after the effective date of this circular.

Delete clauses I.B(ii) and I.C(ii)

Issue 4 – Responsibility of independent directors

Existing language – Clause I.C(i)

> I.C(i) Independent director shall however periodically review legal compliance reports prepared by the company as well as steps taken by the company to cure any taint. In the event of any proceedings against an independent director in connection with the affairs of the company, defence shall not be permitted on the ground that the independent director was unaware of this responsibility.

Discussion

The board as a whole should have the responsibility to periodically review legal compliance reports prepared by the company as well as the steps taken to cure any instances of non-compliance.

A director is an officer of the company and the term "officer who is in default" has already been defined in section 2(31) and section 5 of the Companies Act, 1956. It is therefore not necessary to make any further provision in this respect and the second sentence to clause I(C)(i) may be deleted.

Revised language – Clause I.C(i)

> 49 I C(i) The Board shall periodically review legal compliance reports prepared by the company as well as steps taken by the company to cure instances of non-compliances.

Issue 5 – Amendment to board procedures

Existing language – Clause I.D(iii)

> I.D(iii) Further only the three committees viz. the Audit Committee, the Shareholders' Grievance Committee and the Remuneration Committee shall be considered for this purpose.

Discussion

There is currently a shortage of independent directors. The Companies Act, 1956 prescribes in section 277 that a person cannot hold more than 15 directorships and section 278 provides that in considering the limit, directorship as an alternate director should be excluded, whereas the clause restricts committee memberships to 10. Therefore, independent directors who would otherwise be willing to serve on such committees are unable to do so.

The formation of a remuneration committee is not mandatory and it meets only occasionally. It is therefore suggested that for the purposes of the calculation of the limit, only the audit committee and the shareholders' grievance committee should be counted.

Revised language – Clause I.D(iii)

I.D(iii) Further only two committees viz. the Audit Committee and the Shareholders' Grievance Committee shall be considered for this purpose.

Issue 6 – Term of office of non-executive directors

Existing language – Clause I.F(i)

I.F(i) Person shall be eligible for the office of non-executive director so long as the term of office did not exceed nine years in three terms of three years each, running continuously.

Discussion

The existing language in clause I.F(i) would require that no non-whole time director can continue as a director beyond a period of three consecutive terms of three years each, i.e. a total of nine years. This may create practical problems as it may prevent promoters and directors protecting their interests from continuing on the board even while the promoters' investment in the company continues. It may also prevent the continuance on the board of other individuals, who may be making a significant contribution as a board member and whose continuance on the board may be in the interest of the company.

It can however be argued that long association with the company may be perceived as impairing the independence of a director. It may therefore be provided that where an individual continues on the board beyond the prescribed term of nine years, he shall no longer be considered as an independent director.

It is also necessary that this provision be made prospective, i.e. it should apply to a period of nine years in the aggregate, such period to commence on or after the date the amended clause 49 comes into force. It is therefore necessary that this clause be amended as follows:

Revised language – Clause I.F(i)

I.F(i) A director shall be considered to be an independent director only so long as his tenure on the board does not exceed, in the aggregate, a period of nine years, such period to be considered as commencing on or after the date this circular comes into force or the date of his first appointment as a director, whichever is later. After the expiry of the said period, the director may continue to be a member of the board and be eligible for reappointment on the expiry of his term, but he shall not be considered to be an independent director.

Issue 7 – Requirements related to audit committees

Existing language –Clause II.A(iv)

II.A(iv) The Chairman shall be present at Annual General Meeting to answer shareholder queries

Discussion

It may not be practical for the Chairman of the Audit Committee to be present at all annual general meetings to answer shareholder queries due to various reasons, including travel, ill health, etc. it is therefore recommended that in his absence, another member of the audit committee, who is an independent director may be present to answer shareholder queries.

Revised language –Clause II.A(iv)

II.A(iv) The Chairman of the audit committee, or in his absence, a designated member of the audit committee who is an independent director shall be present at Annual General Meeting to answer shareholder queries

Issue 8 – Meeting of Audit Committee – Clause II.B

Existing language

> II.B The audit committee shall meet at least thrice a year. One meeting shall be held before finalization of annual accounts and one every six months. The quorum shall be either two members or one third of the members of the audit committee, whichever is higher and minimum of two independent directors.

Discussion

Clause II.D(i) requires that the audit committee should have an oversight of the disclosure of financial information. A listed company is required to publish quarterly financial results and annual financial statements. It is therefore necessary that the audit committee should meet at least four times in a year.

Revised language

> II.B The audit committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

Issue 9 – Role of the audit committee

Existing language –Clause II.D

(i) The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

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

3. Reviewing with management the annual financial statements before submission to the board, focusing primarily on;

    a. Any changes in accounting policies and practices.

    b. Major accounting entries based on exercise of judgment by management.

    c. Qualifications in draft audit report.

    d. Significant adjustments arising out of audit.

    e. The going concern assumption.

    f. Compliance with accounting standards.

    g. Compliance with stock exchange and legal requirements concerning financial statements

    h. Any related party transactions

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

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

6. Discussion with internal auditors any significant findings and follow up there on.

7. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.

8. Discussion with external auditors before the audit commences about nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

9. Reviewing the company's financial and risk management policies.

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

> **Explanation (i):** The term "related party transactions" shall have the same meaning as contained in the Accounting Standard 18, Related Party Transactions, issued by The Institute of Chartered Accountants of India.
>
> **Explanation (ii):** If the company has set up an audit committee pursuant to provision of the Companies Act, the company agrees that the said audit committee shall have such additional functions / features as is contained in the Listing Agreement.

Discussion

Section 217(2AA) of the Companies Act, 1956 requires that the Board's report should include a Director's Responsibility Statement which covers many of the items covered in this clause. To ensure consistency, it is necessary to reword some of the clauses.

Revised language –Clause II.D

(i) The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the external auditor and the fixation of audit fees.

3. Approval of payment to external auditors for any other services rendered by the external auditors.

4. Reviewing, with the management, the annual financial statements before submission to the board for approval, with particular reference to:

    a. Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause 2AA of section 217 of the Companies Act, 1956

    b. Changes, if any, in accounting policies and practices and reasons for the same

    c. Major accounting entries involving estimates based on the exercise of judgment by management

    d. Significant adjustments made in the financial statements arising out of audit findings

    e. Compliance with listing and other legal requirements relating to financial statements

    f. Disclosure of any related party transactions

g. Qualifications in the draft audit report.

5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval

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

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

8. Discussion with internal auditors any significant findings and follow up there on.

9. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.

10. Discussion with external auditors before the audit commences about nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

11. Reviewing the company's financial and risk management policies.

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

Explanation (i): The term "related party transactions" shall have the same meaning as contained in the Accounting Standard 18, Related Party Transactions, issued by The Institute of Chartered Accountants of India.

Explanation (ii): If the company has set up an audit committee pursuant to provision of the Companies Act, the company agrees that the said audit committee shall have such additional functions / features as is contained in the Listing Agreement.

Clause II.E.5 becomes redundant and should therefore be deleted.

<u>Issue 10 – Review of information by Audit Committee</u>

Existing language –Clause II.E

(E) Review of information by Audit Committee

(i) The Audit Committee shall mandatorily review the following information:

1. Financial statements and draft audit report, including quarterly / half-yearly financial information;

2. Management discussion and analysis of financial condition and results of operations;

3. Reports relating to compliance with laws and to risk management;

4. Management letters / letters of internal control weaknesses issued by statutory / internal auditors; and

5. Records of related party transactions

6. The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee

Discussion

The requirement in sub-clause 1 is already covered in clause I.D and should be deleted

It is not practical to expect audit committees to review the records of related party transactions. It should be sufficient if management places before the audit committee for review, a statement of significant related party transactions and gives details of related party transactions that are not at an arm's length basis with reasons for the same.

Clause VII provides that risk management procedures should be reviewed by the Board. Therefore, there is no need for the audit committee to also perform this review.

Revised language –Clause II.E

II (E) Review of information by Audit Committee

(i) The Audit Committee shall mandatorily review the following information:

1. Management discussion and analysis of financial condition and results of operations;
2. Statement of significant related party transactions (as defined by the audit committee), submitted by management;
3. Management letters / letters of internal control weaknesses issued by the external auditors;
4. Internal audit reports relating to internal control weaknesses; and
5. The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

Issue 11 – Audit reports and qualifications

Existing language –Clause III.A

A. Disclosure of Accounting Treatment

In case it has followed a treatment different from that prescribed in an Accounting Standards, management shall justify why they believe such alternative treatment is more representative of the underlined business transactions. Management shall also clearly explain the alternative accounting treatment in the footnote of financial statements.

Discussion

Where an accounting standard is not followed, the auditor is required to disclose that fact and qualify his report. What is proposed, in addition, is that management should provide an explanation in a note to the financial statements as to the fact that an accounting standard is not followed and the reason for the departure. The language in the clause does not bring this out.

Since this is a matter of disclosure, it would be more appropriate to delete this clause and include an amended clause under clause VII as sub-clause (AA)

Revised language –Clause VII.AA

AA. Disclosure of Accounting Treatment

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

Issue 12 – Whistle Blower Policy

Existing language –Clause IV.A

(A) Internal Policy on access to Audit Committees:

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

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

iii. Company shall annually affirm that it has not denied any personnel access to the audit committee of the company (in respect of matters involving alleged misconduct) and that it has provided protection to "whistle blowers" from unfair termination and other unfair or prejudicial employment practices.

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

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

Discussion

The intention of this clause is that management establishes 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 exact details of such a mechanism should be left to each company, through its Board of Directors, to decide but the existence and implementation must be reviewed by the audit committee. The mechanism must have adequate provisions to ensure there is no victimization of employees who avail of this procedure. The clause may be reworded accordingly.

Revised language – Clause IV.A

i. The company will establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy.

ii. The mechanism must provide for adequate safeguards against victimization of employees who avail of the mechanism.

iii. The mechanism must also provide, where senior management is involved, direct access to the Chairman of the Audit Committee.

iv. The existence of the mechanism must be appropriately communicated within the organization.

v. The Audit Committee must periodically review the existence and functioning of the mechanism.

Issue 13 – Deletion of redundant clause on internal audit

Existing language –Clause IV.A(v)

IV.A(v) The appointment, removal and terms of remuneration of the chief internal auditor shall be subject to review by the Audit Committee.

Discussion

Clause IV.A(v) dealing with the audit committee review of the appointment, removal and terms of remuneration of the Chief Internal Auditor should be deleted since this is a repetition of clause II.E.6 of clause 49. This ensures absence of redundant language.

Revised language –Clause IV.A(v)

Clause IV.A(v) should be deleted.

Issue 14 – Subsidiary companies

Existing language –Clause V

i. The company agrees that provisions relating to the composition of the Board of Directors of the holding company shall be made applicable to the composition of the Board of Directors of subsidiary companies

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

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

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

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

Discussion

It has been pointed out that the implementation of this clause may create the following practical difficulties:

1. Subsidiaries are often of small size and it may be too onerous if all the provisions regarding the composition of the board as applicable to a holding company are made applicable to every subsidiary. There may also be difficulties in applying this clause to joint ventures, when the composition of the board may be determined by the joint venture agreement.

2. Where there are a large number of subsidiaries, independent directors on the board of the parent company may not be willing to become directors on the board of a subsidiary, particularly where such a directorship is included in the number of directorships to which the ceiling prescribed under the Companies Act, 1956 applies.

3. It may be very expensive for a company if the independent director is required to attend board meetings of foreign subsidiaries

At the same time, it needs to be appreciated that the intention in formulating this clause was the need for the board of the holding company to have some independent link with the board of the subsidiary and provide necessary oversight.

It is therefore suggested that the clause may be revised as under:

1. The provisions of sub-clause (ii), which provide that at least one independent director in the holding company shall be a director of the subsidiary company shall apply only to material Indian subsidiaries i.e. subsidiaries whose turnover or net worth in the immediately preceding year exceeds 20% of the consolidated turnover or consolidated net worth respectively, of the holding company and its subsidiaries.

2. There should be an obligation on the part of the management to bring to the attention of the board of the holding company significant transactions and arrangements entered into by the subsidiary companies. For this purpose, "significant transaction and arrangement" shall mean any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities of the company, as the case may be, in the immediately preceding year.

Clause V (v) pertaining to a disclosure of the review of affairs of a subsidiary company by the board of the parent company should be deleted since it is superfluous. This aspect is already covered in clauses V (iii) and V(iv).

Revised language –Clause V

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

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

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

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

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

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

Issue 15 – Disclosure of contingent liabilities

Existing language –Clause VI

VI(i) The company agrees that management shall provide a clear description in plain English of each material contingent liability and its risks, which shall be accompanied by the auditor's clearly worded comments on the management's view. This section shall be highlighted in the significant accounting policies and notes on accounts, as well as, in the auditor's report, where necessary.

Discussion

The disclosure of contingent liabilities is already required under Schedule VI to the Companies Act, 1956. It is also impractical for auditors to comment on management's views and any such view/comment may be construed as an admission of the liability, which may be detrimental to the interests of the shareholders. It is therefore suggested that this clause be deleted.

Revised language –Clause VI

Delete clause VI(i) in its entirety.

Issue 16 – Basis of related party transactions

Existing language –Clause VII.A(i)

> VII.A(i) A statement of all transactions with related parties including their basis shall be placed before the Audit Committee for formal approval/ratification. If any transaction is not on an arm's length basis, management shall provide an explanation to the Audit Committee justifying the same.

Discussion

It may be cumbersome and unnecessary for the audit committee to review all transactions with related parties which are in the ordinary course of business. It should therefore be sufficient if these transactions are placed periodically in a summary form before the audit committee.

It is however necessary that material individual transactions which are not in the normal course of business are placed before the audit committee. It is also necessary that management identify and place before the audit committee, material individual transactions, whether in the normal course of business or otherwise, with related parties or others which are not on an arm's length basis, together with a justification for the same.

Revised language –Clause VII.A(i)

> VII.A(i) A statement in summary form of transactions with related parties in the ordinary course of business shall be placed periodically before the audit committee.
>
> (ii) Material individual transactions with related parties which are not in the normal course of business shall be placed before the audit committee.
>
> (iii) Material individual transactions with related parties or others which are not on an arm's length basis should be placed before the audit committee, together with Management's justification for the same.

Issue 17 – Board disclosures – risk management

Existing language –Clause VII.B(i)

> VII.B(i) Management shall place a report certified by the compliance officer of the company, before the entire Board of Directors every quarter documenting the business risks faced by the company, measures to address and minimize such risks, and any limitations to the risk taking capacity of the corporation. This document shall be formally approved by the Board.

Discussion

The compliance officer of a company may not be the right person to attest/certify disclosure of the business risks faced by a company. It is recommended that this requirement be deleted.

Revised language –Clause VII.B(i)

Delete clause VII.B(i) in its entirety.

Issue 18 – Proceeds from Initial Public Offering (IPO)

Existing language –Clause VII.C(i)

VII.C(i) When money is raised through an Initial Public Offering (IPO) it shall disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus. This statement shall be certified by the independent auditors of the company. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

Discussion

The current language in clause 49 requires companies to disclose use of IPO proceeds without specifying any time limitation. It is recommended that clause 49 be amended to ensure this disclosure is required only till funds are spent. There is no reason why this provision should apply only to an IPO and not be made applicable to all public offerings.

Further, funds utilised for purposes other than that for which they were raised should be placed before the audit committee.

Revised language –Clause VII.C(i)

When money is raised through an issue to public (including public issues, rights issues), it shall disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus and place it before the audit committee. Such disclosure shall be made only till such time that the full money raised through the issue has been fully spent. This statement shall be certified by the statutory auditors of the company. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

Issue 19 – Remuneration of directors

Existing language –Clause VII.D(ii)(a)

VII.D(ii)(a) All elements of remuneration package of all the directors, i.e. salary, benefits, bonuses, stock options, pension etc.

Discussion

It is recommended that the disclosure of remuneration provided to directors should be aggregated by major category and disclosed. This will facilitate a robust disclosure of director's remuneration.

Revised language –Clause VII.D(ii)(a)

VII.D(ii)(a) All elements of remuneration package of individual directors**, summarized under major groups, such as** salary, benefits, bonuses, stock options, pension etc.

Issue 20 – Management

Existing language –Clause VII.E(i)

VIII.E(i) Management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)

Discussion

Clause VII.E requires management to disclose to the board details of transactions where they have personal interests. It is recommended to change "Management" to "Senior management" as follows, to make the language tighter and more precise.

Revised language –Clause VII.E(i)

> VII.E(i) **Senior** management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)
>
> **Explanation: For this purpose, the term "senior management" shall mean personnel of the company who are members of its management / operating council (i.e. core management team excluding independent directors). This would also include all members of management one level below the executive directors**

Issue 21 – CEO/CFO certification

Discussion

> (a) The CEO and the CFO must assume primary responsibility for ensuring that the company does not enter into transactions which are fraudulent, illegal or violative of the company's code of conduct or ethics policy.

i. Clause (f) which deals with two separate matters viz. (i) internal control and (ii) accounting policies should be split into two clauses as changes an internal control cannot be disclosed in the notes to the financial statements.

Revised language – CEO/CFO certification

The CEO (either the Executive Chairman or the Managing Director or Manager) and the CFO (either the whole-time Finance Director or any other person heading the Finance function) discharging that function shall certify to the Board that:

a. They have reviewed financial statements and the cash flow statement and the Directors' Report and that to the best of their knowledge and belief :

   i. these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;

   ii. 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 which are fraudulent, illegal or violative of the company's code of conduct or ethics policy.

c. They accept responsibility for establishing and maintaining internal controls and that they have evaluated the effectiveness of the internal control systems of the company and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of 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

   i. significant changes in internal control during the year;

   ii. significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and

   iii. instances of significant fraud of which they have become aware and the involvement, if

any, of the management or an employee having a significant role in the company's internal control system.

Issue 22 – Annexure 1C – 4. Postal Ballot

With effect from June 15, 2001, section 192A was introduced in the Companies Act, 1956 providing for the passing of resolutions by postal ballot. Since this is now part of law, it is suggested that paragraph 4 of Annexure 1C be deleted.