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Chairmanship of**

**Shri Kumar Mangalam Birla**

**Report of the Kumar Mangalam Birla Committee on Corporate Governance**

**Preface**

1.1 It is almost a truism that the adequacy and the quality of corporate governance shape growth and the future of any capital market and economy. The concept of corporate governance has been attracting public attention for quite some time in India. The topic is no longer confined to the halls of academia and is increasingly finding acceptance for its relevance and underlying importance in the industry and capital markets. Progressive firms in India have voluntarily placed systems of good corporate governance. Internationally also, while this topic has been accepted for a long time, the financial crisis in emerging markets has led to renewed discussion and inevitably focussed them on the lack of corporate as well as governmental oversight. The same applies to recent high-profile financial reporting failures even among firms in the developed economies. Focus on corporate governance and related issues is an inevitable outcome of a process, which leads firms to increasingly shift to financial markets as the pre-eminent source of capital. In the process, more and more people are recognizing that corporate governance is indispensable to effective market discipline. This growing consensus is both an enlightened and realistic view. In an age where capital flows worldwide, just as quickly as information, a country that does not promote a culture of strong, independent oversight, risks its very stability and health. As a result, the link between a company's management, directors and its financial reporting system has never been more crucial. As the boards provide stewardship of companies, they play a significant role in their efficient functioning.

1.2. Studies of firms in India and abroad have shown that markets and investors take notice of well-managed companies, respond positively to them, and reward such companies, with higher valuations. A common feature of such companies is that they have systems in place, which give sufficient freedom to the boards and management to take decisions towards the progress of their companies and to innovate, while remaining within a framework of effective accountability. In other words they have a system of good corporate governance.

1.3 Strong corporate governance is thus indispensable to resilient and vibrant capital markets. It is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high-quality accounting practices. It is the muscle that moves a vibrant and accessible financial reporting structure. Without financial reporting premised on sound numbers, capital markets will collapse upon themselves.

1.4 Another important aspect of corporate governance relates to issues of insider trading. It is important that insiders do not use their position of knowledge and access to inside information about the company, and take unfair advantage of the resulting information asymmetry. To prevent this from happening, corporates are expected to disseminate the material price sensitive information in a timely and proper manner and also ensure that till such information is made public, insiders abstain from transacting in the securities of the company. The principle should be 'disclose or desist'. This therefore calls for companies to devise an internal procedure for adequate timely disclosures, reporting requirements, confidentiality norms, code of conduct and specific guidelines for the conduct of its directors and employees and other insiders. For example, in many countries there are rules for reporting of transactions by directors and other senior executives of corporates as well as for a report on their holdings, activity in their own shares and net year to year changes in these in the annual report. The rules also cover the dealing in the securities of their companies.

the insiders, especially directors and other senior executives, during sensitive reporting seasons. However, the need for such procedures, reporting requirements and rules also goes beyond corporates to other entities in the financial markets such as Stock Exchanges, Intermediaries, Financial institutions, Mutual Funds and concerned professionals who may have access to sensitive information. This is being dealt with in a comprehensive manner, by a separate group appointed by SEBI, under the Chairmanship of Shri Kumar Mangalam Birla.

1.5 The issue of corporate governance involves besides shareholders, all other stakeholders. The Committee's recommendations have looked at corporate governance from the point of view of all stakeholders and in particular that of the shareholders and investors, because they are the primary stakeholders for corporate governance and also the prime constituency of SEBI. The control and reporting functions of boards, the roles of the various committees of the board, the role of management, all assume special significance when viewed from this perspective. The other perspective looking at corporate governance is from the contribution that good corporate governance makes to the efficiency of a business enterprise, to the creation of wealth and to the country's economic growth. In this sense both these points of view are related and during the discussions at the meetings of the Committee, there was a clear convergence of both points of view.

1.6 At the heart of the Committee's report is the set of recommendations which distinguish the responsibilities and obligations of the boards and the management in instituting the system of good corporate governance and emphasises the rights of shareholders in demanding corporate governance. Many of the recommendations are mandatory. For reasons stated in the report, these recommendations are expected to be enforced on the listed companies for initial and continuing disclosures in a phased manner within specified dates, through the listing agreement. The companies will also be required to disclose separately in their annual reports, a report on corporate governance delineating the steps they have taken to comply with the recommendations of the Committee. This will enable shareholders to know, where they have invested, stand with respect to specific initiatives taken to ensure robust corporate governance. The implementation will be phased. Certain categories of companies will be required to comply with the mandatory recommendations of the report during the financial year 2000-2001, but not later than March 31, 2001, and others during the financial years 2001-2002 and 2002-2003. For non-mandatory recommendations, the Committee hopes that companies would voluntarily implement these. It has been recommended that SEBI may write to the appropriate regulatory bodies and governmental authorities to incorporate where necessary, the recommendations in their regulatory or control framework.

1.7 The Committee recognised that India had in place a basic system of corporate governance and that SEBI has already taken a number of initiatives towards raising the existing standards. The Committee also recognised that the Confederation of Indian Industries had published a code entitled "Desirable Code of Corporate Governance" and was encouraged to note that some forward looking companies have already reviewed or are in the process of reviewing their corporate structures and have also reported in their 1998-99 annual reports the extent to which they complied with the Code. The Committee however felt that under Indian conditions a statutory code rather than a voluntary code would be far more purposive and meaningful, at least in respect of certain key features of corporate governance.

1.8 The Committee however recognised that a system of control should not so hamstring companies so as to impede their ability to compete in the market place. The Committee believes that the recommendations made in this report mark an important step forward and if accepted and followed by the industry, they would raise the standards in corporate governance, strengthen the unitary board system, significantly increase its effectiveness and ultimately serve the objective of maximising shareholder value.

## **The Constitution of the Committee and the Setting for the Report**

2.1 There are some Indian companies, which have voluntarily established high standards of corporate governance, but there are many more, whose practices are a matter of concern. There is also an increasing concern about standards of financial reporting and accountability, especially after losses suffered by investors and lenders in the recent past, which could have been a

with better and more transparent reporting practices. Investors have suffered on account of unscrupulous management of the companies, which have raised capital from the market at inflated valuations and have performed much worse than the past reported figures, leave alone the projections at the time of raising money. Another example of bad governance has been the allotment of promoter's shares, on preferential basis at preferential prices, disproportionate market valuation of shares, leading to further dilution of wealth of minority shareholders. This practice has however since been contained.

2.2 There are also many companies, which are not paying adequate attention to the basic procedures for shareholders' service; for example, many of these companies do not pay adequate attention to redress investors' grievances such as delay in transfer of shares, delay in despatch of share certificates and dividend warrants and non-receipt of dividend warrants; companies do not pay sufficient attention to timely dissemination of information to investors as also to the accuracy of such information. SEBI has been regularly receiving large number of investor complaints on these matters. While enough laws exist to take care of many of these investor grievances, the implementation and inadequacy of penal provisions have left a lot to be desired.

2.3 Corporate governance is considered an important instrument of investor protection, and is therefore a priority on SEBI's agenda. To further improve the level of corporate governance, it was felt for a comprehensive approach at this stage of development of the capital market, to accelerate the adoption of globally acceptable practices of corporate governance. This would ensure that the Indian investors are in no way less informed and protected as compared to their counterparts in the best-developed capital markets and economies of the world.

2.4 Securities market regulators in almost all developed and emerging markets have for long been concerned about the importance of the subject and of the need to raise the standard of corporate governance. The financial crisis in the Asian markets in the recent past have highlighted the need for improved level of corporate governance and the lack of it in certain countries has been mentioned as one of the causes of the crisis. Indeed corporate governance has been a discussed topic at the recent meetings of the International Organisation of Securities Commissions (IOSCO). Besides in an environment in which emerging markets increasingly compete for capital, it is evident that global capital will flow to markets which are better regulated and which offer higher standards of transparency, efficiency and integrity. Raising standards of corporate governance is therefore also extremely relevant in this context.

2.5 In the above mentioned context, the Securities and Exchange Board of India (SEBI) constituted the Committee on Corporate Governance on May 7, 1999 under the Chairmanship of Shri Mangalam Birla, member SEBI Board, to promote and raise the standards of Corporate Governance. The Committee's membership is given in [Annexure 1](#) and the detailed terms of reference are as follows:

- a. *to suggest suitable amendments to the listing agreement executed by the stock exchanges with the companies and any other measures to improve the standards of corporate governance in the listed companies, in areas such as continuous disclosure of material information, both financial and non-financial, manner and frequency of such disclosures, responsibilities of independent and outside directors;*
- b. *to draft a code of corporate best practices; and*
- c. *to suggest safeguards to be instituted within the companies to deal with insider information and insider trading.*

2.6 A number of reports and codes on the subject have already been published internationally. Notable among them are the Report of the Cadbury Committee, the Report of the Greenbury Committee, the Combined Code of the London Stock Exchange, the OECD Code on Corporate Governance and The Blue Ribbon Committee on Corporate Governance in the US. In India, the Government has published a Code of Corporate Governance. In preparing this report, while the Committee viewed these documents to the extent appropriate, the primary objective of the Committee was to view corporate governance from the perspective of the investors and shareholders and to recommend a Code to suit the Indian corporate environment, as corporate governance frameworks are not directly exportable. The Committee also took note of the various steps already taken by SEBI for strengthening corporate governance, some of which are:

- strengthening of disclosure norms for Initial Public Offers following the recommendations of the Committee set up by SEBI under the Chairmanship of Shri Y H Malegam;
- providing information in directors' reports for utilisation of funds and variation between projected and actual use of funds according to the requirements of the Companies Act, 1956, inclusion of cash flow and funds flow statement in annual reports ;
- declaration of quarterly results;
- mandatory appointment of compliance officer for monitoring the share transfer process ensuring compliance with various rules and regulations;
- timely disclosure of material and price sensitive information including details of all events having a bearing on the performance of the company;
- despatch of one copy of complete balance sheet to every household and abridged balance sheet to all shareholders;
- issue of guidelines for preferential allotment at market related prices; and
- issue of regulations providing for a fair and transparent framework for takeovers and substantial acquisitions.

2.7 The Committee has identified the three key constituents of corporate governance as Shareholders, the Board of Directors and the Management and has attempted to identify the role of each of these constituents, their roles and responsibilities as also their rights in the context of good corporate governance. Fundamental to this examination and permeating throughout the report is the recognition of the three key aspects of corporate governance, namely; accountability, transparency and equality of treatment for all stakeholders.

2.8 The pivotal role in any system of corporate governance is performed by the board of directors. It is accountable to the stakeholders and directs and controls the Management. It stewards the company, sets its strategic aim and financial goals and oversees their implementation, puts in place adequate internal controls and periodically reports the activities and progress of the company in a transparent manner to the stakeholders. The shareholders' role in corporate governance is to appoint the directors and the auditors and to hold the board accountable for proper governance of the company by requiring the board to provide them periodically with requisite information, in a transparent fashion, of the activities and progress of the company. The responsibility of the management is to undertake the management of the company in the direction provided by the board, to put in place adequate control systems and to ensure their proper operation and to provide information to the board on a timely basis and in a transparent manner to enable the board to monitor the accountability of Management to it.

2.9 Crucial to good corporate governance are the existence and enforceability of regulations relating to insider information and insider trading. These matters are being currently examined separately by a Group appointed by SEBI under the Chairmanship of Shri Kumar Mangalam Birla.

2.10 Adequate financial reporting and disclosure are the corner stones of good corporate governance. These demand the existence and implementation of proper accounting standards and disclosure requirements. A separate committee appointed by SEBI under the Chairmanship of Y. H. Malegam (who is also a member of this Committee) is examining these issues on a continuing basis. This Committee has advised that while in most areas, accounting standards in India are comparable with International Accounting Standards both in terms of coverage and content, there are a few areas where additional standards need to be introduced in India on an urgent basis. These matters are discussed in greater detail in para 12.1 of this report.

2.11 The Committee's draft report was made public through the media and also put on the website of SEBI for comments. The report was also sent to the Chambers of Commerce, financial institutions, stock exchanges, investor associations, the Association of Merchant Bankers, Association of Mutual funds of India, The Institute of Chartered Accountants of India, Institute of Company Secretaries of India, academicians, experts and eminent personalities in the Indian capital market, foreign investors. A copy of the draft report was also sent to Sir Adrian Caxton who had chaired the Cadbury Committee on Corporate Governance set up by the London Stock Exchange, the Financial Reporting Council and the Accountancy Bodies in the U. K. in 1999.

2.12 The Committee has received comments from most of the above groups. Besides, Sir Adrian Caxton, and several eminent persons in the Indian capital market, have sent detailed comments on the draft report. Separately, the Committee held meetings with the representatives of the

Chambers of Commerce, Chairmen of the Financial Institutions, stock exchanges, investor associations. Thus the Committee had the benefit of the views of almost all concerned entities. They will have a role in corporate governance. The Committee has taken into account the views and comments of these respondents in this final report.

2.13 The Committee puts on record its appreciation of the valuable inputs and painstaking efforts of Shri Anup Srivastava, Vice-President Corporate Strategy and Business Development of Aditya Birla Group, Shri P K Bindlish, Division Chief, SEBI, Shri Umesh Kumar, and other members of the SMDRP department of SEBI, in the preparation of this report.

## **The Recommendations of the Committee**

3.1 This Report is the first formal and comprehensive attempt to evolve a Code of Corporate Governance, in the context of prevailing conditions of governance in Indian companies, as well as the state of capital markets. While making the recommendations the Committee has been of the firm view that any code of Corporate Governance must be dynamic, evolving and should change with the changing context and times. *It would therefore be necessary that this code also is reviewed from time to time, keeping pace with the changing expectations of the investors, shareholders, stakeholders and with increasing sophistication achieved in capital markets.*

### **Corporate Governance –the Objective**

4.1 Corporate governance has several claimants –shareholders and other stakeholders – include suppliers, customers, creditors, the bankers, the employees of the company, the government and the society at large. This Report on Corporate Governance has been prepared by the Committee for SEBI, keeping in view primarily the interests of a particular class of stakeholders, namely, the shareholders, who together with the investors form the principal constituency while not ignoring the needs of other stakeholders.

4.2 *The Committee therefore agreed that the fundamental objective of corporate governance is "enhancement of shareholder value, keeping in view the interests of other stakeholders".* This definition harmonises the need for a company to strike a balance at all times between the enhancement of shareholders' wealth whilst not in any way being detrimental to the interests of other stakeholders in the company.

4.3 In the opinion of the Committee, the imperative for corporate governance lies not merely in drafting a code of corporate governance, but in practising it. Even now, some companies are following exemplary practices, without the existence of formal guidelines on this subject. Standards and rules are important because they provide a framework, which will encourage and enforce good corporate governance; but alone, these cannot raise the standards of corporate governance. What counts is the way in which these are put to use. *The Committee is thus of the firm view, that the best results would be achieved when the companies begin to treat the code not as a mere structure, but as a way of life.*

4.4 It follows that the real onus of achieving the desired level of corporate governance, lies with the companies. It is the proactive initiatives taken by the companies themselves and not in the external measures such as the breadth and depth of a code or stringency of enforcement of norms. The extent of discipline, transparency and fairness, and the willingness shown by the companies themselves in implementing the Code, will be the crucial factor in achieving the desired confidence of shareholders and other stakeholders and fulfilling the goals of the company.

### **Applicability of the Recommendations**

#### **Mandatory and non mandatory recommendations**

5.1 The Committee debated the question of voluntary versus mandatory compliance of its recommendations. The Committee was of the firm view that mandatory compliance of the recommendations at least in respect of the essential recommendations would be most appropriate.

in the Indian context for the present. The Committee also noted that in most of the countries standards of corporate governance are high, the stock exchanges have enforced some form of compliance through their listing agreements.

5.2 The Committee felt that some of the recommendations are absolutely essential for the framework of corporate governance and virtually form its core, while others could be considered desirable. Besides, some of the recommendations may also need change of statute, such as the Companies Act, for their enforcement. In the case of others, enforcement would be possible by amending the Securities Contracts (Regulation) Rules, 1957 and by amending the listing agreement of the stock exchanges under the direction of SEBI. The latter, would be less time-consuming and would ensure speedier implementation of corporate governance. *The Committee therefore felt that the recommendations should be divided into mandatory and non-mandatory categories and those recommendations which are absolutely essential for corporate governance can be defined with precision and which can be enforced through the amendment of the listing agreement could be classified as mandatory. Others, which are either desirable or which do not require change of laws, may, for the time being, be classified as non-mandatory.*

### **Applicability**

5.3 *The Committee is of the opinion that the recommendations should be made applicable to all listed companies, their directors, management, employees and professionals associated with these companies, in accordance with the time table proposed in the schedule given later in this report. Compliance with the code should be both in letter and spirit and should always be in a manner that gives precedence to substance over form. The ultimate responsibility for putting the recommendations into practice lies directly with the board of directors and the management of the company.*

5.4 *The recommendations will apply to all the listed private and public sector companies, in accordance with the schedule of implementation. As for listed entities, which are not company bodies (e.g. private and public sector banks, financial institutions, insurance companies etc.) incorporated under other statutes, the recommendations will apply to them provided that they do not violate their respective statutes, and guidelines or directives issued by the regulatory authorities.*

### **Schedule of implementation**

5.5 The Committee recognises that compliance with the recommendations would involve restructuring the existing boards of companies. It also recognises that some companies, especially the smaller ones, may have difficulty in immediately complying with these conditions.

5.6 *The Committee recommends that while the recommendations should be applicable to all listed companies or entities, there is a need for phasing out the implementation as follows*

- *By all entities seeking listing for the first time, at the time of listing.*
- *Within financial year 2000-2001, but not later than March 31, 2001 by all entities, which are included either in Group 'A' of the BSE or in S&P CNX Nifty index as on January 1, 2001. However to comply with the recommendations, these companies may have to begin the process of implementation as early as possible. These companies would cover more than 80% of the market capitalisation.*
- *Within financial year 2001-2002, but not later than March 31, 2002 by all the entities which are presently listed, with paid up share capital of Rs. 10 crore and above, or net worth of Rs. 25 crore or more any time in the history of the company.*
- *Within financial year 2002-2003, but not later than March 31, 2003 by all the entities which are presently listed, with paid up share capital of Rs 3 crore and above*

*This is a mandatory recommendation.*

### **Board of Directors**

6.1 The board of a company provides leadership and strategic guidance, objective judgment independent of management to the company and exercises control over the company, while remaining at all times accountable to the shareholders. The measure of the board is not just whether it fulfils its legal requirements but more importantly, the board's attitude and the way it translates its awareness and understanding of its responsibilities. An effective corporate governance system is one, which allows the board to perform these dual functions efficiently. The board of directors of a company, thus directs and controls the management of a company and is accountable to the shareholders.

6.2 The board **directs** the company, by formulating and reviewing company's policies, strategies, major plans of action, risk policy, annual budgets and business plans, setting performance objectives, monitoring implementation and corporate performance, and overseeing major expenditures, acquisitions and divestitures, change in financial control and compliance with applicable laws, taking into account the interests of stakeholders. It **controls** the company's management by laying down the **code of conduct**, overseeing the process of disclosure and communications, ensuring that appropriate systems for financial control and reporting and monitoring risk are in place, evaluating the performance of management, chief executive, directors and providing checks and balances to reduce potential conflict between the specific interests of management and the wider interests of the company and shareholders including the misuse of corporate assets and abuse in related party transactions. It is **accountable** to the shareholders for creating, protecting and enhancing wealth and resources for the company and reporting to them on the performance in a timely and transparent manner. However, it is not involved in day-to-day management of the company, which is the responsibility of the management.

#### **Composition of the Board of Directors**

6.3 The Committee is of the view that the composition of the board of directors is critical to the independent functioning of the board. There is a significant body of literature on corporate governance, which has guided the composition, structure and responsibilities of the board. The Committee took note of this while framing its recommendations on the structure and composition of the board.

The composition of the board is important in as much as it determines the ability of the board to collectively provide the leadership and ensures that no one individual or a group is able to dominate the board. The executive directors (like director-finance, director-personnel) are involved in the day to day management of the companies; the non-executive directors bring external perspective and independence to the decision making. Till recently, it has been the practice of most of the companies in India to fill the board with representatives of the promoters of the company, and independent directors if chosen were also handpicked thereby ceasing to be independent. This has undergone a change and increasingly the boards comprise of different groups of directors - promoter director, (promoters being defined by the erstwhile Malegar Committee), executive and non executive directors, a part of whom are independent. A clear distinction has been made by the Committee between two classes of non-executive directors namely, those who are independent and those who are not.

#### **Independent directors and the definition of independence**

6.5 Among the non-executive directors are independent directors, who have a key role in the entire mosaic of corporate governance. The Committee was of the view that it was important that independence be suitably, correctly and pragmatically defined, so that the definition itself does not become a constraint in the choice of independent directors on the boards of companies. The definition should bring out what in the view of the Committee is the touchstone of independence and which should be sufficiently broad and flexible. It was agreed that "material pecuniary relationship which affects independence of a director" should be the litmus test of independence and the board of the company would exercise sufficient degree of maturity when left to its own devices to determine whether a director is independent or not. *The Committee therefore agreed on the following definition of "independence". Independent directors are directors who apart from their director's remuneration do not have any other material pecuniary relationship or transaction with the company, its promoters, its management or its subsidiaries, which in the judgement of the board may affect their independence of judgement. Further, all pecuniary relationships or transactions of the non-executive directors should be disclosed in the annual report.*

6.6 The Blue Riband Committee of the USA and other Committee reports have laid cons

stress on the role of independent directors. The law however does not make any distinction between the different categories of directors and all directors are equally and collectively responsible in law for the board's actions and decisions. *The Committee is of the view that executive directors, i.e. those who are independent and those who are not, help bring an independent judgement to bear on board's deliberations especially on issues of strategy, performance, management of conflicts and standards of conduct. The Committee therefore emphasis on the calibre of the non-executive directors, especially of the independent directors.*

6.7 Good corporate governance dictates that the board be comprised of individuals with personal characteristics and core competencies such as recognition of the importance of the board's tasks, integrity, a sense of accountability, track record of achievements, and the ability to ask tough questions. Besides, having financial literacy, experience, leadership qualities and the ability to think strategically, the directors must show significant degree of commitment to the company and devote adequate time for meeting, preparation and attendance. The Committee is also of the view that it is important that adequate compensation package be given to the non-executive independent directors so that these positions become sufficiently financially attractive to attract talent and that the non-executive directors are sufficiently compensated for their work.

6.8 Independence of the board is critical to ensuring that the board fulfils its oversight role objectively and holds the management accountable to the shareholders. The Committee is therefore, suggested the above definition of independence, and the following structure and composition of the board and of the committees of the board.

*6.9 The Committee recommends that the board of a company have an optimum combination of executive and non-executive directors with not less than fifty percent of the board comprising non-executive directors. The number of independent directors (independence being as defined in the foregoing paragraph) would depend on the nature of the chairman of the board. In case a company has a non-executive chairman, at least one-third of board should comprise of independent directors and in case a company has an executive chairman, at least half of the board should be independent.*

*This is a mandatory recommendation.*

6.10 The tenure of office of the directors will be as prescribed in the Companies Act.

### **Nominee Directors**

7.1 Besides the above categories of directors, there is another set of directors in Indian companies who are the nominees of the financial or investment institutions to safeguard their interest. These nominees of the institutions are often chosen from among the present or retired employees of the institutions or from outside. In the context of corporate governance, there could be arguments for and against the continuation of this practice.

7.2 There are arguments both for and against the institution of nominee directors. Those who favour this practice argue that nominee directors are needed to protect the interest of the institutions who are custodians of public funds and who have high exposures in the project companies both in the form of equity and loans. On the other hand those who oppose this practice while conceding that financial institutions have played a significant role in the industrial development of the country as a sole purveyor of long term credit, argue that there is an inherent conflict when institutions through their nominees participate in board decisions and in their shareholders demand accountability from the board. They also argue that there is a further concern because the institutions are often major players in the stock market in respect of the share companies on which they have nominees.

7.3 The Committee recognises the merit in both points of view. Clearly when companies are well managed and performing well, the need for protection of institutional interest is much less. When companies are badly managed or under-performing, the need for such protection is more. The Committee would therefore recommend that institutions should appoint nominees on the boards of companies only on a selective basis where such appointment is pursuant to a right under loan agreements or where such appointment is considered necessary to protect the interest of the institution.

7.4 The Committee also recommends that when a nominee of the institutions is appointed director of the company, he should have the same responsibility, be subject to the same discipline and be accountable to the shareholders in the same manner as any other director of the company. In particular, if he reports to any department of the institutions on the affairs of the company, the institution should ensure that there exist Chinese walls between such department and other departments which may be dealing in the shares of the company in the stock market.

### **Chairman of the Board**

8.1 The Committee believes that the role of Chairman is to ensure that the board meeting is conducted in a manner which secures the effective participation of all directors, executive directors and executive alike, and encourages all to make an effective contribution, maintain a balance of power in the board, make certain that all directors receive adequate information, well in time and in a form which enables executive directors look beyond their executive duties and accept full share of the responsibility for corporate governance. The Committee is of the view that the Chairman's role should in principle be distinct from that of the chief executive, though the same individual may perform both roles.

*8.2 Given the importance of Chairman's role, the Committee recommends that a non-executive Chairman should be entitled to maintain a Chairman's office at the company's expense and be allowed reimbursement of expenses incurred in performance of his duties. This will enable him to discharge the responsibilities effectively.*

*This is a non-mandatory recommendation.*

### **Audit Committee**

9.1 There are few words more reassuring to the investors and shareholders than an accountancy system of good corporate governance promotes relationships of accountability between the principal actors of sound financial reporting – the board, the management and the auditor. The management accountable to the board and the board accountable to the shareholders. The audit committee's role flows directly from the board's oversight function. It acts as a catalyst for effective financial reporting.

9.2 The Committee is of the view that the need for having an audit committee grows from recognition of the audit committee's position in the larger mosaic of the governance process. It relates to the oversight of financial reporting.

9.3 A proper and well functioning system exists therefore, when the three main groups responsible for financial reporting – the board, the internal auditor and the outside auditors – form the three-legged stool that supports responsible financial disclosure and active and participatory oversight. The audit committee has an important role to play in this process, since the audit committee is a sub-group of the full board and hence the monitor of the process. Certainly, it is not the role of the audit committee to prepare financial statements or engage in the myriad of decisions relating to the preparation of those statements. The committee's job is clearly one of oversight and monitoring and in carrying out this job it relies on senior financial management and the outside auditors. However it is important to ensure that the boards function efficiently for if the boards are dysfunctional, the audit committees will do no better. The Committee believes that the professional standards of governance applicable to the full board should also be applicable to the audit committee.

*9.4 The Committee therefore recommends that a qualified and independent audit committee should be set up by the board of a company. This would go a long way in enhancing the credibility of the financial disclosures of a company and promoting transparency.*

*This is a mandatory recommendation.*

9.5 The following recommendations of the Committee, regarding the constitution, functions and procedures of audit committee would have to be viewed in the above context. But just as there is no "one size fits all" for the board when it comes to corporate governance, same is true for audit committees. The Committee can thus only lay down some broad parameters, within which the audit committee has to evolve its own guidelines.

## **Composition**

9.6 The composition of the audit committee is based on the fundamental premise of independence and expertise.

*The Committee therefore recommends that*

- *the audit committee should have minimum three members, all being non executive with the majority being independent, and with at least one director having financial and accounting knowledge;*
- *the chairman of the committee should be an independent director;*
- *the chairman should be present at Annual General Meeting to answer shareholder queries;*
- *the audit committee should invite such of the executives, as it considers appropriate (particularly the head of the finance function) to be present at the meetings of the Committee but on occasions it may also meet without the presence of any executives of the company. Finance director and head of internal audit and when required, a representative of the external auditor should be present as invitees for the meetings of the audit committee;*
- *the Company Secretary should act as the secretary to the committee.*

*These are mandatory recommendations.*

### **Frequency of meetings and quorum**

9.7 The Committee recommends that *to begin with the audit committee should meet at least once a year. One meeting must be held before finalisation of annual accounts and one necessarily every six months.*

*This is a mandatory recommendation*

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

*This is a mandatory recommendation.*

### **Powers of the audit committee**

9.9 Being a committee of the board, the audit committee derives its powers from the authority of the board. The Committee recommends that such powers should include powers:

- *To investigate any activity within its terms of reference.*
- *To seek information from any employee.*
- *To obtain outside legal or other professional advice.*
- *To secure attendance of outsiders with relevant expertise, if it considers necessary.*

*This is a mandatory recommendation.*

### **Functions of the Audit Committee**

9.10 *As the audit committee acts as the bridge between the board, the statutory auditors and internal auditors, the Committee recommends that its role should include the following*

- *Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.*
- *Recommending the appointment and removal of external auditor, fixation of audit fee and also approval for payment for any other services.*
- *Reviewing with management the annual financial statements before submission to the board, focussing primarily on:
 
  - *Any changes in accounting policies and practices.*
  - *Major accounting entries based on exercise of judgement by management.*
  - *Qualifications in draft audit report.*
  - *Significant adjustments arising out of audit.*
  - *The going concern assumption.*
  - *Compliance with accounting standards*
  - *Compliance with stock exchange and legal requirements concerning financial reporting.**

statements.

- *Any related party transactions i.e. transactions of the company of material nature involving promoters or the management, their subsidiaries or relatives etc. that may have a potential conflict with the interests of company at large.*
- *Reviewing with the management, external and internal auditors, the adequacy of internal control systems.*
- *Reviewing the adequacy of internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure, coverage and frequency of internal audit.*
- *Discussion with internal auditors of any significant findings and follow-up thereon.*
- *Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of material nature and reporting the matter to the board.*
- *Discussion with external auditors before the audit commences, of the nature and scope of audit. Also post-audit discussion to ascertain any area of concern.*
- *Reviewing the company's financial and risk management policies.*
- *Looking into the reasons for substantial defaults in the payments to the depositors, debenture holders, share holders (in case of non-payment of declared dividends) and creditors.*

*This is a mandatory recommendation*

#### **Remuneration Committee of the Board**

10.1 The Committee was of the view that a company must have a credible and transparent policy in determining and accounting for the remuneration of the directors. The policy should avoid potential conflicts of interest between the shareholders, the directors, and the management. An overriding principle in respect of directors' remuneration is that of openness and shareholders are entitled to a full and clear statement of benefits available to the directors.

*10.2 For this purpose the Committee recommends that the board should set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment.*

*This is a non-mandatory recommendation.*

10.3 The Committee however recognised that the remuneration package should be good enough to attract, retain and motivate the executive directors of the quality required, but not more than is necessary for the purpose. The remuneration committee should be in a position to bring an objectivity in determining the remuneration package while striking a balance between the interests of the company and the shareholders.

#### **Composition, Quorum etc. of the Remuneration Committee**

*10.4 The Committee recommends that to avoid conflicts of interest, the remuneration committee which would determine the remuneration packages of the executive directors should comprise at least three directors, all of whom should be non-executive directors, the chairman of the committee being an independent director.*

10.5 The Committee deliberated on the quorum for the meeting and was of the view that the remuneration committee should meet very often. It would not be necessary for the committee to meet very often. *The Committee was of the view that it should not be difficult to arrange for a date to suit the convenience of all the members of the committee. The Committee therefore recommends that all the members of the remuneration committee should be present at the meeting.*

*10.6 The Committee also recommends that the Chairman of the remuneration committee should be present at the Annual General Meeting, to answer the shareholder queries. However, it is up to the Chairman to decide who should answer the queries.*

*All the above recommendations in paragraphs 10.4 to 10.6 are non-mandatory.*

10.7 The Committee recommends that the board of directors should decide the remuneration of non-executive directors.

*This is a mandatory recommendation.*

### **Disclosures of Remuneration Package**

10.8 It is important for the shareholders to be informed of the remuneration of the director company. The Committee therefore recommends that the following disclosures should be included in the section on corporate governance of the annual report:

- All elements of remuneration package of all the directors i.e. salary, benefits, bonuses, stock options, pension etc.
- Details of fixed component and performance linked incentives, along with the performance criteria.
- Service contracts, notice period, severance fees.
- Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

*This is a mandatory recommendation.*

### **Board Procedures**

11.1 The measure of the board is buttressed by the structures and procedures of the board. The various committees of the board recommended in this report would enable the board to have an appropriate structure to assist it in the discharge of its responsibilities. These need to be supplemented by certain basic procedural requirements in terms of frequency of meetings, availability of timely information, sufficient period of notice for the board meeting as well as circulation of agenda items well in advance, and more importantly, the commitment of the members of the board.

11.2 The Committee therefore recommends that board meetings should be held at least once in a year, with a maximum time gap of four months between any two meetings. The minimum information as given in [Annexure 2](#) should be available to the board.

*This is a mandatory recommendation.*

The Committee further recommends that to ensure that the members of the board give due importance and commitment to the meetings of the board and its committees, there should be a ceiling on the maximum number of committees across all companies in which a director can be a member or act as Chairman. The Committee recommends that a director should not be a member of more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director. Furthermore it should be a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

*This is a mandatory recommendation.*

### **Accounting Standards and Financial Reporting**

12.1 Over time the financial reporting and accounting standards in India have been upgraded. However, this is an ongoing process and we have to move speedily towards the adoption of international standards. This is particularly important from the angle of corporate governance. The Committee took note of the discussions of the SEBI Committee on Accounting Standards referred to in the report and makes the following recommendations:

- Consolidation of Accounts of subsidiaries  
The companies should be required to give consolidated accounts in respect of all its subsidiaries in which they hold 51 % or more of the share capital. The Committee was informed that SEBI is already in dialogue with the Institute of Chartered Accountants of India to bring about the changes in the Accounting Standard on consolidated financial statements. The Institute of Chartered Accountants of India should be requested to issue the Accounting Standards for consolidated financial statements expeditiously.
- Segment reporting where a company has multiple lines of business.  
Equally in cases of companies with several businesses, it is important that financial report

respect of each product segment should be available to shareholders and the market to complete financial picture of the company. *The Committee was informed that SEBI was in dialogue with the Institute of Chartered Accountants of India to introduce the Accounting Standards on segment reporting. The Institute of Chartered Accountants of India has already issued Exposure Draft on the subject and should be requested to finalise this at an early date.*

- Disclosure and treatment of related party transactions.

This again is an important disclosure. The Committee was informed that the Institute of Chartered Accountants of India had already issued an Exposure Draft on the subject. *The Committee recommends that the Institute of Chartered Accountants of India should be requested to finalise this at the earliest. In the interim, the Committee recommends the disclosures set out in Clause 4 of Annexure-4*

- Treatment of deferred taxation

The treatment of deferred taxation and its appropriate disclosure has an important bearing on the true and fair view of the financial status of the company. *The Committee recommends that the Institute of Chartered Accountants of India be requested to issue a standard on deferred taxation at an early date.*

### **Management**

13.1 In the view of the Committee, the over-riding aim of management is to maximize shareholder value without being detrimental to the interests of other stakeholders. The management is subservient to the board of directors and must operate within the boundaries and the policy framework laid down by the board. While the board is responsible for ensuring that the principles of corporate governance are adhered to and enforced, the real onus of implementation lies with management. It is responsible for translating into action, the policies and strategies of the board and implementing its directives to achieve corporate objectives of the company framed by the board. It is therefore essential that the board should clearly define the role of the manager.

#### **Functions of the Management**

13.2 The management comprises the Chief Executive, Executive-directors and the key managers of the company, involved in day-to-day activities of the company.

13.3 The Committee believes that the management should carry out the following functions:

- Assisting the board in its decision making process in respect of the company's strategies, policies, code of conduct and performance targets, by providing necessary inputs.
- Implementing the policies and code of conduct of the board.
- Managing the day to day affairs of the company to best achieve the targets and goals set by the board, to maximize the shareholder value.
- Providing timely, accurate, substantive and material information, including financial results and exceptions, to the board, board-committees and the shareholders.
- Ensuring compliance of all regulations and laws.
- Ensuring timely and efficient service to the shareholders and to protect shareholder interests.
- Setting up and implementing an effective internal control systems, commensurate with business requirements.
- Implementing and comply with the Code of Conduct as laid down by the board.
- Co-operating and facilitating efficient working of board committees.

13.4 *As a part of the disclosure related to Management, the Committee recommends that the directors' report or as an addition there to, a Management Discussion and Analysis report should form part of the annual report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company's competitive position:*

- *Industry structure and developments.*
- *Opportunities and Threats*
- *Segment-wise or product-wise performance.*
- *Outlook.*
- *Risks and concerns*
- *Internal control systems and their adequacy.*
- *Discussion on financial performance with respect to operational performance.*
- *Material developments in Human Resources /Industrial Relations front, including new initiatives.*

*people employed.*

*This is a mandatory recommendation*

13.5 Good corporate governance casts an obligation on the management in respect of disclosure. *The Committee therefore recommends that disclosures must be made by the management 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. in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)*

*This is a mandatory recommendation.*

### **Shareholders**

14.1 The shareholders are the owners of the company and as such they have certain rights and responsibilities. But in reality companies cannot be managed by shareholder referendum. Shareholders are not expected to assume responsibility for the management of corporate affairs. The company's management must be able to take business decisions rapidly. The shareholders therefore necessarily delegate many of their responsibilities as owners of the company to directors who then become responsible for corporate strategy and operations. The implementation of this strategy is done by a management team. This relationship therefore brings in the accountability of the boards and the management to the shareholders of the company. A good corporate framework is one that provides adequate avenues to the shareholders for effective contribution in the governance of the company while insisting on a high standard of corporate behaviour without getting involved in the day to day functioning of the company.

### **Responsibilities of shareholders**

14.2 The Committee believes that the General Body Meetings provide an opportunity to the shareholders to address their concerns to the board of directors and comment on and demand explanation on the annual report or on the overall functioning of the company. It is important that the shareholders use the forum of general body meetings for ensuring that the company is properly stewarded for maximising the interests of the shareholders. This is important especially in the Indian context. It follows from the above, that for effective participation shareholders must maintain decorum during the General Body Meetings.

14.3 The effectiveness of the board is determined by the quality of the directors and the accuracy of the financial information is dependent to an extent on the efficiency with which the auditors discharge their duties. The shareholders must therefore show a greater degree of interest and involvement in the appointment of the directors and the auditors. Indeed, they should demand complete information about the directors before approving their directorship.

*14.4 The Committee recommends that in case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information*

- *A brief resume of the director;*
- *Nature of his expertise in specific functional areas; and*
- *Names of companies in which the person also holds the directorship and the membership of Committees of the board.*

*This is a mandatory recommendation*

### **Shareholders' rights**

14.5 The basic rights of the shareholders include right to transfer and registration of shares, obtaining relevant information on the company on a timely and regular basis, participating in shareholder meetings, electing members of the board and sharing in the residual assets of the corporation.

14.6 The Committee therefore recommends that as shareholders have a right to participate in decisions concerning fundamental corporate changes, they should be sufficiently informed on decisions concerning fundamental corporate changes, they should only be provided information as under the Companies Act, but also in respect of other decisions.

relating to material changes such as takeovers, sale of assets or divisions of the company changes in capital structure which will lead to change in control or may result in certain shareholders obtaining control disproportionate to the equity ownership.

*14.7 The Committee recommends that information like quarterly results, presentation material to analysts may be put on company's web-site or may be sent in such a form as to enable the stock exchange on which the company is listed to put it on its own web-site.*

*This is a mandatory recommendation.*

*14.8 The Committee recommends that the half-yearly declaration of financial performance including summary of the significant events in last six-months, should be sent to each household shareholder.*

*This is a non-mandatory recommendation.*

14.9 A company must have appropriate systems in place which will enable the shareholders to participate effectively and vote in the shareholders' meetings. The company should also keep shareholders informed of the rules and voting procedures, which govern the general shareholders meetings.

14.10 The annual general meetings of the company should not be deliberately held at inconvenient times. The timing should not be such which makes it difficult for most of the shareholders to attend. The company must also ensure that it is not inconvenient or expensive for shareholders to cast their vote.

14.11 Currently, although the formality of holding the general meeting is gone through, in practice only a small fraction of the shareholders of that company do or can really participate therein. This virtually makes the concept of corporate democracy illusory. It is imperative that a situation which has lasted too long needs an early correction. In this context, for shareholders who are unable to attend the meetings, there should be a requirement which will enable them to vote by postal ballot for key decisions. A detailed list of the matters which should require postal ballot is given in [Annexure 3](#). This would require changes in the Companies Act. The Committee was informed that SEBI has already made recommendations in this regard to the Department of Company Affairs.

*14.12 The Committee recommends that a board committee under the chairmanship of a senior executive director should be formed to specifically look into the redressing of shareholder complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. The Committee believes that the formation of such a committee will help focus the attention of the company on shareholders' grievances and sensitise the management to redressal of their grievances.*

*This is a mandatory recommendation*

*14.13 The Committee further recommends that to expedite the process of share transfer, the board of the company should delegate the power of share transfer to an officer, or a committee to the registrar and share transfer agents. The delegated authority should attend to share transfer formalities at least once in a fortnight.*

*This is a mandatory recommendation.*

#### **Institutional shareholders**

14.14 Institutional shareholders have acquired large stakes in the equity share capital of Indian companies. They have or are in the process of becoming majority shareholders in many listed companies and own shares largely on behalf of the retail investors. They thus have a greater responsibility given the weightage of their votes and have a bigger role to play in corporate governance as retail investors look upon them for positive use of their voting rights.

14.15 Given the weight of their votes, the institutional shareholders can effectively use them to influence the standards of corporate governance. Practices elsewhere in the world have indicated that institutional shareholders can sufficiently influence because of their collectiv

the policies of the company so as to ensure that the company they have invested in, comply with the corporate governance code in order to maximise shareholder value. What is important in the view of the Committee is that, the institutional shareholders put to good use their voting power.

14.16 The Committee is of the view that the institutional shareholders

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

#### **Manner of Implementation**

15.1 *The Committee recommends that SEBI writes to the Central Government to amend Securities Contracts (Regulation) Rules, 1957 for incorporating the mandatory provisions of the Report.*

15.2 *The Committee further recommends to SEBI, that as in other countries, the mandatory provisions of the recommendations may be implemented through the listing agreement of the stock exchanges.*

15.3 *The Committee recognises that the listing agreement is not a very powerful instrument and the penalties for violation are not sufficiently stringent to act as a deterrent. The Committee therefore recommends to SEBI, that the listing agreement of the stock exchanges be strengthened and the exchanges themselves be vested with more powers, so that they can ensure proper compliance of code of Corporate Governance. In this context the Committee further recommends that the Securities Contract (Regulation) Act, 1956 should be amended, so that in addition to the above, the concept of listing agreement be replaced by listing conditions.*

15.4 *The Committee recommends that the Securities Contracts (Regulation) Act, 1956 be amended to empower SEBI and stock exchanges to take deterrent and appropriate action on violation of the provisions of the listing agreement. These could include power of levying monetary penalty both on the company and the concerned officials of the company and filing winding-up petition etc.*

15.5 *The Committee also recommends that SEBI write to the Department of Company Affairs for suitable amendments to the Companies Act in respect of the recommendations which fall within their jurisdiction.*

15.6 *The Committee recommends that there should be a separate section on Corporate Governance in the annual reports of companies, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory recommendation with reasons thereof and an extent to which the non-mandatory recommendations have been adopted should be specifically highlighted. This will enable the shareholders and the securities market to assess for themselves the standards of corporate governance followed by a company. A suggested list of items to be included in the compliance report is enclosed in [Annexure 4](#).*

*This is a mandatory recommendation.*

15.7 *The Committee also recommends that the company should arrange to obtain a certificate from the auditors of the company regarding compliance of mandatory recommendations and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same certificate should also be sent to the stock exchanges along with the returns filed by the company.*

*This is a mandatory recommendation*

#### **End Note**

There are several corporate governance structures available in the developed world but there is no one structure, which can be singled out as being better than the others. There is no "one size fits all" structure for corporate governance. The Committee's recommendations are not therefore based on any one model but are designed for the Indian environment.

Corporate governance extends beyond corporate law. Its fundamental objective is not merely the fulfillment of the requirements of law but in ensuring commitment of the board in managing the company in a transparent manner for maximising long term shareholder value. The corporate governance has as many votaries as claimants. Among the latter, the Committee has primarily focussed its recommendations on investors and shareholders, as they are the prime constituents of SEBI. Effectiveness of corporate governance system cannot merely be legislated by law. No system of corporate governance can be static. As competition increases, technology advances, and communication speeds up, the environment in which companies operate in India also changes. In this dynamic environment the systems of corporate governance also need to evolve. The Committee believes that its recommendations will go a long way towards setting the standards of corporate governance in Indian firms and make them attractive destinations for local and global capital. These recommendations will also form the base for further evolution of the structure of corporate governance in consonance with the rapidly changing economic and environment of the country in the new millennium.

## **Annexure 1**

### **Names of the Members of the committee**

Shri Kumar Mangalam Birla, Chairman, Aditya Birla group

#### ***Chairman of the Committee***

1. Shri Rohit Bhagat, Country Head, Boston Consulting Group
2. Dr. J Bhagwati, Jt. Secretary, Ministry of Finance.
3. Shri Samir Biswas, Regional Director, Western Region, Department of Company Affairs, Government of India
4. Shri S.P. Chhajed, President of Institute of Chartered Accountants of India
5. Shri Virender Ganda, Ex-President of Institute of Company Secretaries of India
6. Dr. Sumantra Ghoshal, Professor of Strategic Management, London Business School
7. Shri Vijay Kalantri, President, All India Association of Industries
8. Shri Pratip Kar, Executive Director, SEBI — Member Secretary
9. Shri Y. H. Malegam, Managing Partner, S.B. Billimoria & Co
10. Shri N. R. Narayana Murthy, Chairman and Managing Director, Infosys Technologies Ltd.
11. Shri A K Narayanan, President of Tamil Nadu Investor Association
12. Shri Kamal Parekh, Ex-President, Calcutta Stock Exchange (Shri J M Chaudhary – Presently Chairman, Calcutta Stock Exchange)
13. Dr. R. H. Patil, Managing Director, National Stock Exchange Ltd.
14. Shri Anand Rathi, President of the Stock Exchange, Mumbai
15. Ms D.N. Raval, Executive Director, SEBI
16. Shri Rajesh Shah, Former President of Confederation of Indian Industries.
17. Shri L K Singhvi, Sr. Executive Director, SEBI
18. Shri S. S. Sodhi, Executive Director, Delhi Stock Exchange

## **Annexure 2**

### **Information to be placed before board of directors**

1. Annual operating plans and budgets and any updates.
2. Capital budgets and any updates.
3. Quarterly results for the company and its operating divisions or business segments.
4. Minutes of meetings of audit committee and other committees of the board.
5. The information on recruitment and remuneration of senior officers just below the board level, including appointment or removal of Chief Financial Officer and the Company Secretary.
6. Show cause, demand and prosecution notices which are materially important
7. Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.
8. Any material default in financial obligations to and by the company, or substantial non-compliance with financial obligations.

- payment for goods sold by the company.
9. Any issue, which involves possible public or product liability claims of substantial nature including any judgement or order which, may have passed strictures on the conduct of the company or taken an adverse view regarding another enterprise that can have negative implications on the company.
  10. Details of any joint venture or collaboration agreement.
  11. Transactions that involve substantial payment towards goodwill, brand equity, or intangible property.
  12. Significant labour problems and their proposed solutions. Any significant developments on the Human Resources/ Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc.
  13. Sale of material nature, of investments, subsidiaries, assets, which is not in normal course of business.
  14. Quarterly details of foreign exchange exposures and the steps taken by management to mitigate the risks of adverse exchange rate movement, if material.
  15. Non-compliance of any regulatory, statutory nature or listing requirements and shareholder service such as non-payment of dividend, delay in share transfer etc.

### **Annexure 3**

#### **POST BALLOT SYSTEM**

##### ***Rationale***

Voting at the general meetings of companies is the most valuable and fundamental mechanism through which the shareholders accept or reject the proposals of the board of directors as regards the structure, the strategy, the ownership and the management of the corporation. Voting is the mechanism available with the shareholders for exercising an external check on the board of management.

Under the present framework of the Companies Act, 1956, a company is required to obtain the approval of its shareholders for various important decisions such as increase in its authorized capital, shifting of registered office, change in the name, amalgamation and reconstitution, buy-back of shares, further issue of shares, etc. Since the shareholders of any large public listed company are scattered throughout the length and breadth of the country, they are unable to physically attend the general meetings of the company to exercise their right to vote on matters of vital importance. The system of voting by proxy has also not proved very effective.

With a view to strengthening shareholder democracy, it is felt that all the shareholders of a company should be given the right to vote on certain critical matters through a postal ballot system which has also been envisaged in the Companies Bill, 1997.

##### **Items requiring voting by postal ballot**

**Some of the critical matters which should be decided by this system are –**

1. matters relating to alteration in the memorandum of association of the company like change in name, objects, address of registered office etc;
2. sale of whole or substantially the whole of the undertaking;
3. sale of investments in the companies, where the shareholding or the voting rights of the company exceeds 25%;
4. Making a further issue of shares through preferential allotment or private placement;
5. Corporate restructuring;
6. Entering a new business area not germane to the existing business of the company;
7. Variation in the rights attached to class of securities.

##### ***Procedure for the postal ballot***

Where a resolution is to be passed in relation to any of the aforesaid items through postal

1. The board of directors shall appoint a Designated-Person to conduct, supervise and the exercise of postal ballot. This person may be the Company Secretary, a retired, any person of repute who, in the opinion of the board, can conduct the voting process in a fair & transparent manner.
2. All communications in this regard shall be made by and addressed directly to the said Designated-Person.
3. A notice containing a draft of the resolutions and the necessary explanatory statements shall be sent to all members entitled to vote requesting them to send their assent or dissent within a period of thirty days from the date of posting of the letter.
4. The notice shall be sent under certificate of posting and shall include with the notice a paid postage envelope for facilitating the communication of the assent or the dissent of the shareholders to the resolutions within the said period.
5. The envelope by post will be received directly by the Post Office through Box No. and will be obtained by the Designated-Person in advance and will be indicated on each prepaid envelope to be used by the members for sending the resolution.
6. The Designated-Person shall ascertain the will of the shareholders based on the replies received and the resolution shall be deemed to have been duly passed if approved by a majority of members not less in number, *than* as prescribed by law.
7. The Designated-Person shall thereafter give a report to the Chairman and on the basis of such report the Chairman shall declare the results of the poll.

#### **Annexure 4**

#### **Suggested List Of Items To Be Included In The Report On Corporate Governance In Annual Report Of Companies**

1. A brief statement on company's philosophy on code of governance.
2. Board of Directors:
  - Composition and category of directors for example promoter, executive, non-executive, independent non-executive, nominee director, which institution represented as Lender or equity investor.
  - Attendance of each director at the BoD meetings and the last AGM.
  - Number of BoD meetings held, dates on which held.
3. Audit Committee.
  - Brief description of terms of reference
  - Composition, name of members and Chairperson
  - Meetings and attendance during the year
4. Remuneration Committee.
  - Brief description of terms of reference
  - Composition, name of members and Chairperson
  - Attendance during the year
  - Remuneration policy
  - Details of remuneration to all the directors, as per format in main report.
5. Shareholders Committee.
  - Name of non-executive director heading the committee
  - Name and designation of compliance officer
  - Number of shareholders complaints received so far
  - Number not solved to the satisfaction of shareholders
  - Number of pending share transfers
6. General Body meetings.

- Location and time, where last three AGMs held.
- Whether special resolutions
  - Were put through postal ballot last year, details of voting pattern
  - Person who conducted the postal ballot exercise
  - Are proposed to be conducted through postal ballot
  - Procedure for postal ballot

#### 7. Disclosures.

- Disclosures on materially significant related party transactions i.e. transactions of the company of material nature, with its promoters, the directors or the management, the subsidiaries or relatives etc. that may have potential conflict with the interests of the company.
- Details of non-compliance by the company, penalties, strictures imposed on the company by the Stock Exchange or SEBI or any statutory authority, on any matter related to capital during the last three years.

#### 8. Means of communication.

- Half-yearly report sent to each household of shareholders.
- Quarterly results
  - Which newspapers normally published in.
  - Any website, where displayed
  - Whether it also displays official news releases; and
  - The presentations made to institutional investors or to the analysts.
- Whether MD&A is a part of annual report or not.

#### 9. General Shareholder information

- AGM : Date, time and venue
- Financial Calendar
- Date of Book closure
- Dividend Payment Date
- Listing on Stock Exchanges
- Stock Code
- Market Price Data : High., Low during each month in last financial year
- Performance in comparison to broad-based indices such as BSE Sensex, CRISIL index
- Registrar and Transfer Agents
- Share Transfer System
- Distribution of shareholding
- Dematerialization of shares and liquidity
- Outstanding GDRs/ADRs/Warrants or any Convertible instruments, conversion date and likely impact on equity
- Plant Locations
- Address for correspondence

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[BACK](#)