CHAPTER – 3

COMMITTEES ON CORPORATE GOVERNANCE

Various Committees Reports and Recommendations on Corporate Governance

With the formation of corporate form of organizations, the framework of corporate governance got wide recognition and quite peculiarly it was prevalent in various manifestations throughout the world. The theme of Corporate Governance has got recognition due to the constitution and formation of various committees and formulation of various laws throughout the world.

With respect to India, after the economic initiatives in 1991, the Govt. of India thought it fit to respond to the developments taking place throughout the world over and accordingly the initiatives recommended by Cadbury Committee Report got prominence. In order to give due prominence Confederation of Indian Industry (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM) and, the Securities and Exchange Board of India (SEBI) constituted committees to recommend initiatives in Corporate Governance.

The report of various committees helped a lot to streamline the corporate throughout the world. Some of the Committees with its formation is given under the following table 3.1.
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However with respect to India, the recommendations of Naresh Chandra Committee, Dr. J. J. Irani Committee constituted by Ministry of Corporate Affairs, the Kumar Mangalam Birla Committee and N. R. Narayana Murthy Committee constituted by SEBI are more prominent. Apart from these committees, there are OECD principles and reviews by various other corporate bodies like FICCI, KPMG, ICSI etc. on the corporate governance practices in India.

Some of the recommendations of these committees are as follows:

**Overview of SEBI Committee / Narayana Murthy Committee Report on Corporate Governance:**

In order to ameliorate the condition of investor protection the Securities and Exchange Board of India (“SEBI”) constituted a committee on (the “Committee”). The Committee comprised members from various walks of public and professional life. This includes captains of industry, academicians, public accountants and people from financial press and from industry forums. The issues discussed by the Committee primarily related to audit committees, audit reports, independent directors, related parties, risk management, directorships and director compensation, codes of conduct and financial disclosures. The Committee’s recommendations in the final report were selected based on parameters including their relative
importance, fairness, and accountability, and transparency, ease of implementation, verifiability and enforceability.

The key mandatory recommendations focus on strengthening the responsibilities of audit committees; improving the quality of financial disclosures, including those related to related party transactions and proceeds from initial public offerings; requiring corporate executive boards to assess and disclose business risks in the annual reports of companies; introducing responsibilities on boards to adopt formal codes of conduct; the position of nominee directors; and stock holder approval and improved disclosures relating to compensation paid to non-executive directors. Non-mandatory recommendations include moving to a regime where corporate financial statements are not qualified; instituting a system of training of board members; and the evaluation of performance of board members.

Corporate governance initiatives in India began in 1998 with the Desirable Code of Corporate Governance – a voluntary code published by the CII, and the first formal regulatory framework for listed companies specifically for corporate governance, established by the SEBI. The latter was made in February 2000, following the recommendations of the Kumarmangalam Birla Committee Report.

The SEBI Committee on Corporate Governance (the “Committee”) was constituted under the Chairmanship of Shri N. R. Narayana Murthy, Chairman and Chief Mentor of Infosys Technologies Limited.

The Committee met thrice on December 7, 2002, January 7, 2003 and February 8, 2003, to deliberate the issues related to corporate governance and finalize its recommendations to SEBI.

SEBI Committee also recommend that the mandatory recommendations in the report of the Naresh Chandra Committee, insofar
as they related to corporate governance, be mandatorily implemented by SEBI through an amendment to clause 49 of the Listing Agreement.

**Key Issues Discussed and Recommendations of SEBI Committee:**

**Audit Committees:**

Suggestions were received from members that audit committees of publicly listed companies should be required to review the following information mandatorily:

- Financial statements;
- Management discussion and analysis of financial condition and results of operations;
- Reports relating to compliance with laws and to risk management;
- Management letters / letters of internal control weaknesses issued by statutory / Internal Auditors; and
- Records of related party transactions.

**Mandatory recommendation:**

Audit committees of publicly listed companies should be required to review the following information mandatorily:

- Financial statements and draft audit report, including quarterly / half-yearly financial information;
- Management discussion and analysis of financial condition and results of operations;
- Reports relating to compliance with laws and to risk management;
- Management letters / letters of internal control weaknesses issued by statutory internal auditors; and
- Records of related party transactions.
**Mandatory Recommendation:**

All audit committee members should be “financially literate” and at least one member should have accounting or related financial management expertise.

Explanation 1 – The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation 2 – A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities.

**Audit Reports and Audit Qualifications:**

**Mandatory Recommendation:**

In case a company has followed a treatment different from that prescribed in an accounting standard, management should justify why they believe such alternative treatment is more representative of the underlying business transaction. Management should also clearly explain the alternative accounting treatment in the footnotes to the financial statements.

**Non-mandatory recommendation**

Companies should be encouraged to move towards a regime of unqualified financial statements. This recommendation should be reviewed at an appropriate juncture to determine whether the financial reporting climate is conducive towards a system of filing only unqualified financial statements.
Related Party Transactions:

Mandatory recommendation

A statement of all transactions with related parties including their bases should be placed before the independent audit committee for formal approval / ratification.

If any transaction is not on an arm’s length basis, management should provide an explanation to the audit committee justifying the same.

Mandatory recommendation

The term “related party” shall have the same meaning as contained in Accounting Standard 18, Related Party Transactions, issued by the Institute of Chartered Accountants of India.

Risk Management

Mandatory recommendation

Procedures should be in place to inform Board members about the risk assessment and minimization procedures. These procedures should be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

Management should place a report before the entire Board of Directors every quarter documenting the business risks faced by the company, measures to address and minimize such risks, and any limitations to the risk taking capacity of the corporation. This document should be formally approved by the Board.

Training of Board members:

Non-mandatory recommendation:

Companies should be encouraged to train their Board members in the business model of the company as well as the risk profile of the business parameters of the company, their responsibilities as directors, and the best ways to discharge them.
Proceeds from Initial Public Offerings ("IPO"): Mandatory recommendation

Companies raising money through an Initial Public Offering ("IPO") should disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis.

On an annual basis, the company shall prepare a statement of funds utilised for purposes other than those stated in the offer document/prospectus. This statement should be certified by the independent auditors of the company. The audit committee should make appropriate recommendations to the Board to take up steps in this matter.

Code of Conduct:
Mandatory recommendation

It should be obligatory for the Board of a company to lay down the code of conduct for all Board members and senior management of a company. This code of conduct shall be posted on the website of the company.

All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The annual report of the company shall contain a declaration to this effect signed off by the CEO and COO.

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 Board of Directors). Normally, this would comprise all members of management one level below the executive directors.
**Nominee Directors:**

**Mandatory recommendation**

There shall be no nominee directors.

Where an institution wishes to appoint a director on the Board, such appointment should be made by the shareholders. An institutional director, so appointed, shall have the same responsibilities and shall be subject to the same liabilities as any other director. Nominee of the Government on public sector companies shall be similarly elected and shall be subject to the same responsibilities and liabilities as other directors.

**Non-Executive Director Compensation:**

**Mandatory recommendation**

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

Companies should publish their compensation philosophy and statement of entitled compensation in respect of non-executive directors in their annual report.

Alternatively, this may be put up on the company’s website and reference drawn thereto in the annual report.

Companies should disclose on an annual basis, details of shares held by non-executive directors, including on an “if-converted” basis.

Non-executive directors should be required to disclose their stock holding (both own or held by / for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors,
prior to their appointment. These details should accompany their notice of appointment.

**Independent Directors:**

The term “independent director” is defined as a non-executive director of the company who:

- apart from receiving director remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;
- is not related to promoters or management at the board level or at one level below the board;
- has not been an executive of the company in the immediately preceding three financial years;
- is not a partner or an executive of the statutory audit firm or the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.
- is not a supplier, service provider or customer of the company. This should include lessor-lessee type relationships also; and
- is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares.

The considerations as regards remuneration paid to an independent director shall be the same as those applied to a non-executive director.

**Whistle Blower Policy:**

**Mandatory recommendation**

Personnel who observe an unethical or improper practice (not necessarily a violation of law) should be able to approach the audit committee without necessarily informing their supervisors.
Companies shall take measures to ensure that this right of access is communicated to all employees through means of internal circulars, etc. The employment and other personnel policies of the company shall contain provisions protecting “whistle blowers” from unfair termination and other unfair prejudicial employment practices.

**Mandatory recommendation**

Companies shall annually affirm that they have not denied any personnel access to the audit committee of the company (in respect of matters involving alleged misconduct) and that they have provided protection to “whistle blowers” from unfair termination and other unfair or prejudicial employment practices. The appointment, removal and terms of remuneration of the chief internal auditor must be subject to review by the Audit Committee. Such affirmation shall form a part of the Board report on Corporate Governance that is required to be prepared and submitted together with the annual report.

**Subsidiary Companies:**

**Mandatory recommendation**

The provisions relating to the composition of the Board of Directors of the holding company should be made applicable to the composition of the Board of Directors of subsidiary companies.

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

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

The minutes of the Board meetings of the subsidiary company shall be placed for review at the Board meeting of the parent company.
The Board report of the parent company should state that they have reviewed the affairs of the subsidiary company also.

**Real Time Disclosures:**

It was suggested that SEBI should issue rules relating to real-time disclosures of certain events or transactions that may be of importance to investors, within 3-5 business days. These would include events such as (a) a change in the control of the company, (b) a company’s acquisition / disposal of a significant amount of assets, (c) bankruptcy or receivership, (d) a change in the company’s independent auditors, and (e) the resignation of a director.

**Evaluation of Board Performance:**

**Non-mandatory recommendation:**

The performance evaluation of non-executive directors should be by a peer group comprising the entire Board of Directors, excluding the director being evaluated; and

Peer group evaluation should be the mechanism to determine whether to extend / continue the terms of appointment of non-executive directors.

**Analyst Reports:**

**Mandatory recommendation:**

**SEBI should make rules for the following:**

- Disclosure in the report issued by a security analyst whether the company that is being written about is a client of the analyst’s employer or an associate of the analyst’s employer, and the nature of services rendered to such company, if any; and
- Disclosure in the report issued by a security analyst whether the analyst or the analyst’s employer or an associate of the analyst’s employer hold or held (in the 12 months immediately preceding the date of the report) or intend to hold any debt or equity instrument
in the issuer company that is the subject matter of the report of the analyst.

**Report of Naresh Chandra Committee on Corporate Governance:**

**Recommendations of the Naresh Chandra Committee:**

**Disclosure of Contingent Liabilities:**

**Mandatory recommendation:**

Management should provide a clear description in plain English of each material contingent liability and its risks, which should be accompanied by the auditor’s clearly worded comments on the management’s view. This section should be highlighted in the significant accounting policies and notes on accounts, as well as, in the auditor’s report, where necessary.

This is important because investors and shareholders should obtain a clear view of a company’s contingent liabilities as these may be significant risk factors that could adversely affect the company’s future financial condition and results of operations.

**CEO / CFO Certification:**

**Mandatory recommendation:**

For all listed companies, there should be a certification by the CEO (either the Executive Chairman or the Managing Director) and the CFO (whole-time Finance Director or other person discharging this function) which should state that, to the best of their knowledge and belief:

- They have reviewed the balance sheet and profit and loss account and all its schedules and notes on accounts, as well as the cash flow statements and the Directors’ Report;
- These statements do not contain any material untrue statement or omit any material fact nor do they contain statements that might be misleading;
• These statements together present a true and fair view of the company, and are in compliance with the existing accounting standards and / or applicable laws / regulations;
• They are responsible for establishing and maintaining internal controls and have evaluated the effectiveness of internal control systems of the company; and they have also disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of internal controls, if any, and what they have done or propose to do to rectify these;
• They have also disclosed to the auditors as well as the Audit Committee, instances of significant fraud, if any, that involves management or employees having a significant role in the company’s internal control systems; and
• They have indicated to the auditors, the Audit Committee and in the notes on accounts, whether or not there were significant changes in internal control and / or of accounting policies during the year.

**Independent Director Exemptions:**

**Recommendation:**

Legal provisions must specifically exempt non-executive and independent directors from criminal and civil liabilities under certain circumstances. SEBI should recommend that such exemptions need to be specifically spelt out for the relevant laws by the relevant departments of the Government and independent regulators, as the case may be.

However, independent directors should 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, defense should not be permitted on the ground that the independent director was unaware of this responsibility.
**Other Suggestions:**

The Committee noted that major differences between the requirements under clause 49 and the provisions of the Companies Act, 1956 should be identified. SEBI should then recommend to the Government that the provisions of the Companies Act, 1956 be changed to bring it in line with the requirements of the Listing Agreement.

**Removal of Independent Directors:**

The Committee noted that under the existing provisions, companies are required to inform the stock exchanges of any changes in directors. The existing safeguards are adequate and hence no further action is required.

**Corporate Governance Ratings:**

It was suggested that corporate governance practices followed by companies should be rated using rating models. It was also suggested that companies should be rated based on parameters of wealth generation, maintenance and sharing, as well as on corporate governance.

**Media Scrutiny:**

The Committee noted that SEBI should consider discussing this issue with representatives of the media, especially the financial press.

**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 mere fulfillment of the requirements of law, but, in ensuring commitment of the Board in managing the company in a transparent manner for maximizing long-term shareholder value.
The Securities and Exchange Board of India (SEBI) appointed a committee on corporate governance on 7 May 1999, with 18 members under the chairmanship of Kumar Mangalam Birla with a view to promoting and raising the standards of corporate governance. The committee’s terms of reference were: (a) to suggest suitable amendments to the listing agreement (LA) 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 in the companies to deal with insider information and insider trading.

The committee submitted its famous and oft-quoted report to SEBI after several sittings of debates and deliberations. The Kumar Mangalam Birla Committee’s report is indeed a veritable landmark in the evolution of corporate governance in India.

The Birla Committee’s recommendations consist of mandatory recommendations, and non-mandatory recommendations:

**Mandatory Recommendations:**
- Applicability
- Board of Directors
- Audit Committee
- Remuneration Committee
- Board Procedures
- Management
- Shareholders

**Non-mandatory Recommendations:**
- Chairman of the Board
SEBI'S Response:

SEBI considered and adopted in its meeting held on 25 January 2000, the recommendations of the Kumar Mangalam Birla Committee on Corporate Governance appointed by it. In accordance with the guidelines provided by SEBI, the stock exchanges in India have modified the listing requirements by incorporating in them a new clause (Clause 49), so that proper disclosure for ensuing corporate governance is made by companies.

SEBI’s Code of Corporate Governance requires that the following information be placed by a company before the board of directors periodically:

- Annual operating plans and budgets and any updates
- Capital budgets and any updates
- Quarterly results for the company and its operating divisions or business segments
- Minutes of audit committee meetings
- Information on recruitment and remuneration of senior officers just below the board level
- Material communications from government bodies
- Fatal or serious accidents, dangerous occurrences, or any material effluent pollution problems
- Details of any joint venture or collaboration agreement
- Labour relations
- Material transactions which are not in the ordinary course of business
- Disclosures by the management on material transactions, if any, with potential for conflict of interest
• Quarterly details of foreign exchange exposures and risk management strategies
• Compliance with all regulatory and statutory requirements

Non-compliance of any of the mandatory recommendations, which is part of the listing agreement with reasons thereof, and the extent to which the non-mandatory requirements have been adopted, are to be specifically highlighted.

Confederation of Indian Industry (CII) recommendations on Corporate Governance:

In 1996, the Confederation of Indian Industry (CII) took a special initiative on corporate governance, the first ever institutional initiative in Indian Industry. This initiative flowed from public concerns regarding the protection of investors, the promotion of transparency within business and industry, the need to move towards international standards in terms of disclosure of information by the corporate sector and, through all of this to develop a high level of public confidence in business and industry.

Recommendations:

• A single board, if it performs well, can maximize long-term shareholder value. The board should meet at least six times a year, preferably at intervals of 2 months.

• A listed company with a turnover of ₹ 100 crores and above should have professionally competent and recognized independent non-executive directors who should constitute
  o At least 30 per cent of the board, if the chairman of the company is a non-executive director or
  o At least 50 per cent of the board, if the chairman and managing director is the same person

• A person should not hold directorships in more than 10 listed companies
• For non-executive directors to play a significant role in corporate decision making and maximizing long term shareholder value, they need to
• Become active participants in boards and not just passive advisors
• Have clearly defined responsibilities within the board such as the audit committee and
• Know how to read a balance sheet, profit and loss account, cash flow statement and financial ratios and have some knowledge of various company laws. This, of course, excludes those who are invited to join boards as experts in other fields such as science and technology
• To secure better effort from non-executive directors, companies should
  o pay a commission over and above the sitting fees for the use of the professional inputs. Commission are rewards on current profits
  o consider offering stock options, so as to relate rewards to performance. Stock options are rewards contingent upon future appreciation corporate value.
• While re-appointing members of the board, companies should give the attendance record of the concerned directors. If a director has not been present (absent with or without leave) for 50 per cent or more meetings, then this should be explicitly stated in the resolution that is put to vote. One should not re-appoint any directors who has not had the time to attend even 50 per cent of the meetings
• Key information that must be reported to, and placed before the board, must contain the following:
  o annual operating plans and budgets, together with up-dated long term plans
  o capital budgets, manpower and overhead budgets
  o fatal or serious accidents, dangerous occurrence, and any effluent or pollution problems
default in payment of interest or non-payments of the principal on any public deposit and/or to any secured creditor or financial institution

- defaults such as non-payment of the principal on any company or materially substantial non-payments for goods sold by the company

- details of any joint venture or collaboration agreement

- transactions that involve substantial payment towards goodwill, brand equity or intellectual property

- recruitment and remuneration of senior officers just below the board level, including appointment or removal of the chief financial officer and the company secretary

- labour problems and their proposed solutions

- quarterly details of foreign exchange exposure and the steps taken by management to limit the risks of adverse exchange rate movement

- for all companies with paid-up capital of ₹ 20 crores or more, the quality and quantity of disclosure that accompanies a GDR issue should be the norm for any domestic issue.

- Under “additional Shareholder's Information”, listed companies should give data on the following:
  - high and low monthly averages of share prices in a major stock exchange where the company is listed for the reporting year
  - greater detail on business segments up to 10 per cent of turnover, giving share in sales revenue, review of operations, analysis of markets and future prospects

- companies that default on fixed deposits should not be permitted to accept further deposits and make inter-corporate loans or investments or declare dividends until the default is made good

- major Indian Stock Exchanges should insist upon a compliance certificate, signed by the CEO and the CFO which should clearly state the following:
the company will continue in business in the course of the following year

the accounting policies and principles conform to the standard practice

the management is responsible for the preparation, integrity and fair presentation of financial statements and other information contained in the annual report

the board has overseen the company’s system of internal accounting and administrative controls either directly or through its audit committee.

**Cadbury Committee Recommendations on Corporate Governance:**


The Cadbury Code of Best practices had 19 recommendations. The recommendations are in the nature of guidelines relating to Board of Directors, Non-executive Directors, Executive Directors and those on Reporting and Control. Relating to the Board of Directors these are:

- The Board should meet regularly retain full and effective control over the company and monitor the executive management
- There should be a clearly accepted division of responsibilities at the head of a company, which will ensure balance of power and authority, such that no individual has unfettered powers of decision. In companies where the Chairman is also the Chief Executive, it is essential that there should be a strong and
independent element on the Board, with a recognized senior member.

- The Board should include non-executive Directors of sufficient caliber and number for their views to carry significant weight in the Board’s decisions.

- The Board should have a formal schedule of matters specifically reserved to it for decisions to ensure that the direction and control of the company is firmly in its hands.

- There should be an agreed procedure for Directors in the furtherance of their duties to take independent professional advice if necessary, at the company’s expense.

- All directors should have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are followed and that applicable rules and regulations are complied with. Any question of the removal of Company Secretary should be a matter for the Board as a whole.

Relating to the Non-Executive Directors the recommendations are:

- Non-executive Directors should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct.

- The majority should be independent of the management and free from any business or other relationship, which could materially interfere with the exercise of their independent judgement, apart from their fees and shareholding. Their fees should reflect the time, which they commit to the company.

- Non-executive Directors should be appointed for specified terms and reappointment should not be automatic.

- Non-executive Directors should be selected through a formal process and both, this process and their appointment, should be a matter for the Board as a whole.
For the Executive Directors the recommendations in the Cadbury Code of Best Practices are:

- Director’s service contracts should not exceed three years without shareholders’ approval
- There should be full and clear disclosure of their total emoluments and those of the Chairman and the highest-paid UK Directors, including pension contributions and stock options. Separate figures should be given for salary and performance-related elements and the basis on which performance is measured should be explained.
- Executive Directors’ pay should be subject to the recommendations of a Remuneration Committee made up wholly or mainly of Non-executive Directors.

And on Reporting and Controls the Cadbury Code of Best Practices stipulate that:

- It is the Board’s duty to present a balanced and understandable assessment of the company’s position.
- The Board should ensure that an objective and professional relationship is maintained with the Auditors.
- The Board should establish an Audit Committee of at least three Non-executive Directors with written terms of reference, which deal clearly with its authority and duties.
- The Directors should explain their responsibility for preparing the accounts next to a statement by the Auditors about their reporting responsibilities.
- The Directors should report on the effectiveness of the company’s system of internal control
- The Directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.

During the 1990’s the issue of director’s remuneration was becoming a primary concern for investors and the public at large. Specifically, the levels of remuneration of directors in privatised industries were rising and remuneration packages were failing to provide the necessary incentives for directors to perform better.

Consequently, it was recognised that corporate governance issues relating to director’s remuneration needed to be addressed in a more rigorous manner. This led to the establishment of the Greenbury Committee.

The Committee’s findings were documented in the Greenbury Report, which incorporated a Code of Best Practice on Director’s Remuneration. Specifically, four main issues were dealt with, as follows:

- the role of a Remuneration Committee in setting the remuneration packages for the CEO and other directors;
- the required level of disclosure needed by shareholders regarding details of directors remuneration and whether there is the need to obtain shareholder approval;
- specific guidelines for determining a remuneration policy for directors; and
- service contracts and provisions binding the Company to pay compensation to a director, particularly in the event of dismissal for unsatisfactory performance.

As in the Cadbury Code, the Greenbury Code recommended the establishment of a Remuneration Committee, comprising entirely of non-executive directors, to determine the remuneration of the executive directors. However, in terms of service contracts, Greenbury recommended a maximum notice period of 12 months rather than three years as suggested by Cadbury.
Following publication, the recommendations of Greenbury were also taken on board by the London Stock Exchange and incorporated into the UK Listing Rules. However, unlike the Cadbury Code it was not widely accepted as many believed that the recommendations made did not sufficiently deal with the issue of linking directors pay to the Company's performance in the interests of shareholders.

**Report of Hampel Committee on Corporate Governance:**

The Hampel Committee was established in 1996 to review and revise the earlier recommendations of the Cadbury and Greenbury Committees. The Final report emphasized principles of good governance rather than explicit rules in order to reduce the regulatory burden on companies and avoid ‘box-ticking’ so as to be flexible enough to be applicable to all companies. It was recognised that good corporate governance will largely depend on the particular situation of each company. This emphasis on principles would survive into the Combined Code.

Hampel viewed governance from a strict principal/agente perspective regarding corporate governance as an opportunity to enhance long term shareholder value, which was asserted as the primary objective of the company. This was a new development from the Cadbury and Greenbury Codes which had primarily focused on preventing the abuse of the discretionary authority entrusted to management. In particular, the report favoured greater shareholder involvement in company affairs. For example, while the report recommended that unrelated proposals should not be bundled under one resolution shareholders, particularly institutional shareholders, were expected to adopt a, ‘considered policy’ on voting.

Another key advance was in the area of accountability and audit. The Board was identified as having responsibility to maintain a sound system of internal control, thereby safeguarding shareholders’ investments (although the Board was not required to report on the effectiveness of the controls). Further, the Board was to be held accountable for all aspects of risk
management, as opposed to just the financial controls as recommended by Cadbury.

Hampel did not advance the debate on director’s remuneration, choosing only to reiterate principles inherent in Greenbury. In particular Hampel did not believe that directors’ remuneration should be a matter for shareholder approval in general meeting. This would not become a requirement until the introduction of The Directors’ Remuneration Report Regulations in 2002.

SOME RECOMMENDATIONS OF VARIOUS COMMITTEES

The recommendations of the following Committees have been outlined as under:

• Cadbury Committee
• King Committee
• CII Committee
• Hampel Committee
• Naresh Chandra Committee

Cadbury Committee:

• The boards of all listed companies registered in the UK should comply with the Code of Best Practice. As many other companies as possible should aim at meeting its requirements.
• Listed companies reporting in respect of years ending after 30 June 1993 should make a statement about their compliance with the Code in the report and accounts and give reasons for any areas of non-compliance.
• Companies’ statements of compliance should be reviewed by the auditors before publication. The review should cover only those parts of the compliance statement which relate to provisions of the Code where compliance can be objectively verified. The Auditing Practices Board should consider guidance for auditors accordingly.
• All parties concerned with corporate governance should use their influence to encourage compliance with the Code. Institutional shareholders in particular, with the backing of the Institutional Shareholders’ Committee, should use their influence as owners to ensure that the companies in which they have invested comply with the Code.

• The Committee’s sponsors, convened by the Financial Reporting Council, should appoint a new Committee by the end of June 1995 to examine how far compliance with the Code has progressed, how far our other recommendations have been implemented, and whether the Code needs updating. Our sponsors should also determine whether the sponsorship of the new Committee should be broadened and whether wider matters of corporate governance should be included in its brief. In the meantime the present Committee will remain responsible for reviewing the implementation of its proposals.

• The Companies Act should be amended to come into line with the requirement of the Code that directors’ service contracts should not exceed three years without shareholders’ approval.

• Companies should expand their interim reports to include balance sheet information. The London Stock Exchange should consider amending the continuing obligations accordingly. There should not be a requirement for a full audit, but interim reports should be reviewed by the auditors and the Auditing Practices Board should develop appropriate guidance. The Accounting Standards Board in conjunction with the London Stock Exchange should clarify the accounting rules which companies should follow in preparing interim reports. The inclusion of cash flow information should be considered by the Committee’s successor body.

• Fees paid to audit firms for non-audit work should be fully disclosed. The essential principle is that disclosure should enable the relative significance of the company’s audit and non-audit fees to the audit firm to be assessed, both in a UK context and, where appropriate, a
worldwide context. The 1991 Regulations under the Companies Act should be reviewed and amended as necessary.

- The accountancy profession should draw up guidelines on the rotation of audit partners.

- Directors should report on the effectiveness of their system of internal control, and the auditors should report on their statement. The accountancy profession together with representatives of preparers of accounts should draw up criteria for assessing effective systems of internal control and guidance for companies and auditors.

- Directors should state in the report and accounts that the business is a going concern, with supporting assumptions or qualifications as necessary, and the auditors should report on this statement. The accountancy profession together with representatives of preparers of accounts should develop guidance for companies and auditors.

- The question of legislation to back the recommendations on additional reports on internal control systems and going concern should be decided in the light of experience.

- The Government should consider introducing legislation to extend to the auditors of all companies the statutory protection already available to auditors in the regulated sector (banks, building societies, insurance, and investment business) so that they can report reasonable suspicion of fraud freely to the appropriate investigatory authorities.

- The accountancy profession together with the legal profession and representatives of preparers’ of accounts should consider further the question of illegal acts other than fraud.

- The accounting profession should continue its efforts to improve its standards and procedures so as to strengthen the standing and independence of auditors.

- Institutional investors should disclose their policies on the use of their voting rights.

- The Committee gives its full support to the objectives of the Financial Reporting Council and the Accounting Standards Board. It welcomes
the action by the Financial Reporting Review Panel over companies whose accounts fall below accepted reporting standards.

- The Committee supports the initiative of the Auditing Practices Board on the development of an expanded audit report. It also gives its full support to the lead which it is taking on the development of auditing practice generally.

- The Committee welcomes the statement by the Institutional Shareholders’ Committee on the Responsibilities of Institutional Shareholders in the UK.

- Issues which the Committee has identified that its successor body may wish to review or consider in greater depth include: the application of the Code to smaller listed companies; directors’ training; the rules for disclosure of directors’ remuneration, and the role which shareholders could play; a requirement for inclusion of cash flow information in interim reports; and the procedures for putting forward resolutions at general meetings. The Committee and its successor will also keep watch on developments regarding the nature and extent of auditors’ liability.

- The board should meet regularly, retain full and effective control over the company and monitor the executive management.

- There should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognised senior member.

- The board should include non-executive directors of sufficient calibre and number for their views to carry significant weight in the board’s decisions.

- The board should have a formal schedule of matters specifically reserved to it for decision to ensure that the direction and control of the company is firmly in its hands.
• There should be an agreed procedure for directors in the furtherance of their duties to take independent professional advice if necessary, at the company’s expense.

• All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are complied with. Any question of the removal of the company secretary should be a matter for the board as a whole.

• Non-executive directors should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct.

• The majority should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. Apart from their fees and shareholding, their fees should reflect the time which they commit to the company.

• Non-executive directors should be appointed for specified terms and reappointment should not be automatic.

• Non-executive directors should be selected through a formal process and both this process and their appointment should be a matter for the board as a whole.

• Directors’ service contracts should not exceed three years without shareholders’ approval.

• There should be full and clear disclosure of directors’ total emoluments and those of the chairman and highest-paid UK director, including pension contributions and stock options. Separate figures should be given for salary and performance-related elements and the basis on which performance is measured should be explained.

• Executive directors’ pay should be subject to the recommendations of a remuneration committee made up wholly or mainly of non-executive directors.
• It is the board’s duty to present a balanced and understandable assessment of the company’s position.
• The board should ensure that an objective and professional relationship is maintained with the auditors.
• The board should establish an audit committee of at least three non-executive directors with written terms of reference which deal clearly with its authority and duties.
• The directors should explain their responsibility for preparing the accounts next to a statement by the auditors about their reporting responsibilities.
• The directors should report on the effectiveness of the company’s system of internal control.
• The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.

**Kings III Committee**

**Boards and Directors**

• All companies should be headed by a unitary board comprised of majority of non-executive directors.
• There should be a minimum of two executive directors on the board – the Chief Executive Officer (CEO) and the director responsible for the finance function.
• The board chairman should be an independent non-executive director.
• The board should appoint the CEO, who should be separate from the chairman.
• The board should meet as often as required to fulfil their duties, preferably at least four times per annum.
• The board should appreciate that sustainability is not separate from strategy, risk and performance and should link long term sustainability to strategy to create business opportunities.
• The board should ensure an effective risk-based internal audit and the integrity of the integrated report.
• The board should ensure that there is transparent and effective communication with stakeholders on both positive and negative aspects of the business.
• The board should report on the effectiveness of the company’s system of internal controls in the integrated report.
• The following should be disclosed in the integrated report:
  • The board and board committee’s composition, the number of meetings held, attendance and activities
  • The length of service and age of directors
  • Significant directorships of each board member
  • The reasons for the cessation of appointment of directors
  • The education, qualification and experience of directors
  • Any actual or potential connections or Exposure
  • Whether supervising of management is required in which case retention of board experience should be called for.
• The board should appoint an audit, risk, and remuneration and nomination committee.
• Board committees, other than the risk committee, should comprise only of board members and should have a majority of non-executive directors. The majority of these non-executive directors should be independent. Other than the executive committee which is usually chaired by the CEO, all committees should be chaired by an independent non-executive director.
• The performance of the board, its committees and individual directors should be assessed annually and the results thereof should be disclosed in the integrated report, along with actions plans to be implemented, if any.
• A policy to pay salaries on average above the median requires special justification.

Key changes from King II
• The majority of non-executive directors should be independent.
• Non-executive directors should not receive share options.
• The chairman and non-executive directors should not receive incentive awards geared to the share price or corporate performance.
• The remuneration policy should be approved by shareholders at the annual general meeting.
• The chairman of the board should be independent and free of conflicts of interest on appointment. Failing which, the board should consider appointing a lead independent non-executive director.
• Changes have been made to the definitions of non-executive directors and independent directors as follows:
• The memorandum of incorporation should allow the board to remove any director including executive directors.
• Adopting and implementing policies and procedures of the holding company in the operations of the subsidiary company should be a matter for the board of the subsidiary company to consider and approve, if the subsidiary company’s board considers it appropriate. The subsidiary company should disclose this adoption and implementation in its integrated report.
• The retired CEO should not become chairman of the board of the same company until three years have passed since the end of his/her tenure as an executive director and an assessment of his/her independence has been performed.
• The remuneration of each individual director and the three most highly paid employees who are not directors of the company should be disclosed.
• Every year, the chairman and the board should evaluate the independence of independent non-executive directors. The classification of directors in the integrated report as independent should be done on the basis of this assessment.
• If an independent non-executive director has served on the board for more than nine years, the board should assess if his/her independence has been impaired. If not, a statement that the
independent director’s independence of character and judgement has not been affected or impaired should be included in the integrated report.

- The integrated report should disclose any external advisers who regularly attend or are invited to attend committee meetings.

Many of these requirements are a continuation from King II, with at times more stringent or updated requirements and expansion in certain areas. The themes are however consistent. The major area of change, after criticism of the King II Report and media and press coverage of the issue, is a major strengthening of the remuneration oversight requirements.

**Non-executive Director**

An individual not involved in the management of the company. An individual in the full-time employment of the holding company is also considered to be a non-executive director of a subsidiary company unless the individual, by his conduct or executive authority, is involved in the day-to-day management of the subsidiary.

**Independent Non-executive Director**

A non-executive director who:

- Is not a representative of a major shareholder who can control or significantly influence management or the board
- Does not have a material direct or indirect interest in the company / group which:
  - Is greater than 5% of the group’s total number of shares in issue
  - Is less than 5% of the group’s total number of shares in issue, but is material to his/her personal wealth
- Has not been employed by the group or appointed as designated auditor or partner in the group’s external audit firm, or senior legal adviser in the previous 3 financial years
- Is not related (immediate family) to someone who has been employed by the group in an executive capacity in the previous 3 financial years
• Is not a professional advisor to the group
• Is free from any other business or relationship that could be a conflict, such as being a director of a material customer of or supplier to the company
• Does not receive remuneration based on the company’s performance

Audit Committees
• The board should ensure that an effective and independent audit committee consisting of at least three members is established that complies with the Companies Act requirements in terms of appointment and membership.
• The audit committee should be chaired by an independent non-executive director and not the board chairman.
• The board chairman should not be an audit committee member, but may attend meetings by invitation.
• Audit committee members should collectively have an understanding of integrated reporting (including financial reporting), internal financial controls, the external and internal audit process, corporate law, risk management, sustainability issues, information technology governance and the governance processes within the company.
• The audit committee is responsible for the oversight of integrated reporting, internal audit and external audit and should determine annually whether the expertise, resources and experience of the finance function is appropriate.
• The audit committee should recommend to the board to engage an external assurance provider to provide assurance over material elements of the sustainability part of the integrated report. The audit committee should evaluate the independence and credentials of the external assurance provider.
• The audit committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities.
• The audit committee must recommend to shareholders the appointment, reappointment and removal of external auditors. For listed companies, the audit committee should ensure that the external auditor that is recommended is approved by the JSE.

• The audit committee must develop a policy for board approval as to the nature, extent and terms under which the external auditor may perform non-audit services.

• Regardless of whether the audit committee has been assigned responsibility by the board for the oversight of risk management, it should satisfy itself that financial reporting risks, internal financial controls and fraud and IT risks as they relate to financial reporting have been appropriately addressed.

• The audit committee should evaluate the nature and extent of a formal documented review of internal financial controls to be performed by internal audit. The audit committee must conclude and report yearly to the board and stakeholders on the effectiveness of the company’s internal financial controls.

Key changes from King II
• The audit committee of a public company and state-owned company must be appointed by shareholders at the AGM.

• The audit committee should receive and deal appropriately with any complaints relating either to the accounting practices and internal audit of the company or to the content or auditing of its financial statements, or to any related matter.

• The audit committee should report in the integrated report:
  • The committee’s role
  • Existence of formal terms of reference and if these have been adhered to
  • Names and qualification of members and the period for which they have served
  • The number of and attendance at meetings
• Whether it has considered and recommended the internal audit charter for approval by the board
• A description of the working relationship with the chief audit executive
• Information regarding any other responsibilities
• Whether it has complied with its legal, regulatory or other responsibilities
• Whether it has recommended the integrated report to the board for approval
• The audit committee should report at the AGM:
  • A description of how the functions were carried out
  • Satisfaction with the auditors independence
  • Any commentary considered appropriate in relation to the financial statements, accounting practices and internal financial control
• The board is required to develop a process for notifying the audit committee of reportable irregularities.
• The audit committee should annually evaluate the resources and expertise in the financial function. For listed companies the audit committee should evaluate the financial director.
• The audit committee should ensure that the internal audit function is subject to an independent quality review, either in line with IIA standards or when the audit committee deems it appropriate.
• The audit committee should understand how the board and external auditor (and any other relevant external assurance provider) evaluate materiality for integrated reporting purposes.

Various changes and additions to the requirements were made to take the new Companies Act requirements into account and to strengthen the role and expectation of the audit committee. The requirement for the listed company’s audit committees to satisfy themselves as to the experience and competence of the finance director and for listed company’s external auditors to be approved by the JSE were included in King III in order to align it with the JSE Listing Requirements. The fact that the audit
committee has been made responsible for overseeing integrated reporting and assurance of sustainability information is linked to the fact that sustainability per King III should be linked to the company’s strategy and risks and has thus a more prominent role to play in the company.

The Governance of Risk

- The board is ultimately responsible for the governance of risk and is required to approve the risk management policy and plan.
- Risk tolerance and risk appetite limits should be set and monitored by the board.
- The execution of the risk strategy should be delegated to management and an experienced Chief Risk Officer (CRO) can assist with this. However ownership cannot reside in one person or function. Risk management has to be embedded into the day to day operations of the company.
- The board should appoint a risk committee or it may be assigned to the audit committee. The risk committee should comprise a minimum three members (non-exec and exec) and the committees responsibilities should be defined in its terms of reference.
- The board should disclose its views on the effectiveness of the company’s risk management in the integrated report. Furthermore it should include undue, unexpected or unusual risks it has taken in the pursuit of reward as well as any material losses and the causes of the losses, with due regard to the company’s commercially privileged information.

Key changes from King II

- An accepted and appropriate methodology should be adopted to identify, respond to and monitor risks. The risk assessment should include a framework to anticipate unpredictable risks, the framework should have the following characteristics:
  - Insight: the ability to identify the cause of the risk, where there are multiple causes or root causes that are not immediately obvious.
• Information: comprehensive information about all aspects of risks and risk sources, especially of financial risks.
• Incentives: the ability to separate risk origination and risk ownership ensuring proper due diligence and accountability.
• Instinct: the ability to avoid ‘following the herd’ when there are systemic and pervasive risks.
• Independence: the ability to view the company independently from its environment.
• Interconnectivity: the ability to identify and understand how risks are related, especially when their relatedness might exacerbate the risk.
• Each year, internal audit should provide a written assessment on the effectiveness of the company’s system of internal control and risk management to the board. This provides the board with independent assurance on the integrity and robustness of the risk management process.

King III focuses on defining roles and responsibilities for risk management which is crucial in the successful embedding of risk management within organisations. Supporting this is the concept that risk must not reside with one person or function, i.e. the CRO or the risk management function but requires an inclusive approach across the company in order to be successful. The other key focus in this chapter is the adoption of an acceptable risk management approach/framework based on key principles rather than prescriptive measures. In the last few years we have experienced significant corporate failures which in many instances could be said is due a company’s failure to anticipate and react to risks. This includes risks that are systemic, as well as risks that are normally considered to be unpredictable; King III has identified this flaw in the approach to risk management and has recommended that companies consider these risks within a defined framework with specific characteristics.
The Governance of Information Technology

- Information Technology (IT) governance should be part of a company’s governance structures and responsibility rests with the board.

- The board should ensure that the company’s IT strategy is integrated with overall business strategy and processes. IT should be leveraged to improve the performance and sustainability of the company.

- The board should delegate to management the responsibility of implementing an IT governance framework. The CEO should appoint a person responsible for the management of IT, i.e. Chief Information Officer (CIO). The CIO should be a suitable qualified and experienced person that has access to regularly interact on strategic IT matters.

- The board should monitor and evaluate significant IT investments and expenditure. This includes monitoring the value delivery of IT and the ROI of significant IT projects. In addition, independent assurance should be obtained on the IT governance practices of IT services outsourced to a third party.

- IT should form an integral part of the company’s risk management practices and management should regularly demonstrate to the board that adequate business resilience arrangements are in place for disaster recovery. In addition, the board is responsible for ensuring that the company complies with relevant IT laws, rules, codes and standards.

- It is the board’s responsibility to ensure that information assets are managed effectively. This includes information security, information management and information privacy.

- The risk and audit committee should assist the board in carrying out its IT responsibilities. The risk committee should ensure and obtain assurance that IT risks are adequately addressed. The audit committee should consider IT risks as it relates to financial reporting and the going concern of the company. In addition, technology should be used to improve audit coverage and efficiency.
Key changes from King II

- There is significantly more focus on IT. King II only addressed aspects relating to IT internal control, potential benefits from utilizing technology to enhance reporting and transparency and the governance implications of e-business.

- King III addresses the key governance areas related to information technology and clearly places the responsibility of IT governance with the board.

As technology becomes increasingly important and integrated into business processes, the need for adequate governance and management of IT resources become imperative for any business. There are increased risks to organisations that embrace technology and therefore directors should ensure that reasonable steps have been taken by management to govern IT. Companies are making significant investments in technology without being able to demonstrate the value delivered from such investments. IT governance is an integral part of corporate governance and should not be seen in isolation. King III address IT governance in a separate chapter as it is a relatively new concept within corporate governance, however, companies should address IT governance within their existing corporate governance framework.

**Compliance with Laws, Codes, Rules and Standards**

- Compliance should be part of the risk management process, the culture of the company and the detailed polices and procedures.

- The structure, size, role and reporting line of the compliance function should be considered to ensure that it is appropriate for the company and should reflect the company’s decision on how compliance is integrated with its ethics and risk management.

- Compliance is a board responsibility and should be a standing agenda item.
• The board should disclose in the integrated report how it has discharged its responsibility to ensure the establishment of an effective compliance framework and process.

Key changes from King III:
• The board and each individual director has a duty to keep abreast of laws, regulations, rules and standards applicable to the company as well as being accountable for the company’s compliance with these.

Corporate compliance is taken to new level. Although corporate compliance was referred to in various sections of King II, King III dedicates a chapter specifically on compliance with laws, regulations, rules, codes and standards. It is not just compliance to the minimum laws and regulations only, i.t.o. “keeping us out of trouble” that is prescribed, but consideration is given to adherence with “non-binding” rules, codes and standards to achieve good governance is envisaged. Compliance is also not being “diluted” by marginalising it into the operations and / or that the company will be tempted to have operational issues take precedent over compliance issues.

Internal Audit
• Companies should establish and maintain an effective internal audit function and if the board decides not to establish an internal audit function, full reasons should be provided in the company’s integrated report.
• As part of its key responsibilities, internal audit is required to evaluate the company’s governance processes including ethics, especially “tone at the top”.
• Where outsourcing of the internal audit function is selected a senior executive or director should be responsible for the effective functioning of the internal audit activities.
• Internal audit should adopt a risk based approach and should be informed by and aligned to the strategy of the company.
• Internal audit, as a significant role player in the governance process, should contribute to the effort to achieve strategic objectives and should provide effective challenge to all aspects of the governance, risk management and internal control environment.

• An internal audit function should consider the risks that may prevent or slow down the realisation of strategic goals as well as the opportunities that will promote the realisation of strategic goals.

• The audit committee should ensure the internal audit function is subject to an independent quality assurance review in line with the IIA standards.

• The Chief Audit Executive (CAE) should develop a sound working relationship with the audit committee by positioning internal audit as a trusted strategic adviser to the audit committee.

Key changes from King II

• Internal audit should provide a written assessment of the effectiveness of the system of internal controls and risk management to the board. The assessment regarding internal financial controls should be reported specifically to the audit committee.

• Internal audit should play a pivotal role in the combined assurance model by providing independent assurance on risk management and internal controls.

• Internal audit should be strategically aligned to achieve its objectives and the CAE should have a standing invitation to executive and other strategically relevant meetings.

Internal audit executives are being continually pressured to improve their function’s effectiveness and efficiency while increasing risk coverage and business improvement focus. Executive management and the audit committee continue to look to internal audit for balanced focus between compliance and business improvement.
In today’s dynamic business world where risks change and emerge daily, internal audit needs to remain relevant and ensure they are flexible enough to align their work to the changing landscape. This supports the concept of internal audit being strategically aligned, furthermore the skills required within the internal audit need to keep up to these demands,

An independent quality assurance review is in line with the requirements of the International Internal Audit Standards for Professional Practice of Internal Auditing. Many audit committees and CAE’s are requesting these independent reviews to:

- Provide the audit committee and executives with an independent assessment of the extent that internal audit function meets leading practices
- Determine the extent the work performed by the internal audit function complies with the “Standards” as prescribed by the Institute of Internal Auditors (IIA)
- Create an improvement agenda

With the shortage of skills and business focusing on their core activities, more and more internal audit functions are being outsourced. This is recognised but it is emphasised that the responsibility and accountability has to remain with the organisation. The move to a combined assurance model is as a result of numerous risk providers such as risk management, legal and compliance, etc, within an organisation operating in silos with a lack of coordination. Internal audit is an integral part of the combined assurance model and as the board is required to report on the effectiveness of the systems of internal control they are now also looking for a written assessment from internal audit to guide them in this assessment. However, management and internal audit will need to define the components of the internal audit framework to which the internal control environment can be measured.
CII Committee

- The Task Force believes that having a well-functioning Nomination Committee will play a significant role in giving investors substantial comfort about the process of Board-level appointments. It, therefore, recommends that listed companies should have a Nomination Committee, comprising a majority of independent directors, including its chairman. This Committee’s task should be to:
  - Search for, evaluate, shortlist and recommend appropriate independent directors and NEDs, subject to the broad directions of the full Board; and
  - Design processes for evaluating the effectiveness of individual directors as well as the Board as a whole.
- The Nomination Committee should also be the body that evaluates and recommends the appointment of executive directors.
- A separate section in the chapter on corporate governance in the annual reports of listed companies could outline the work done by the Nomination Committee during the year under consideration.
- The Task Force recommends that listed companies should issue formal letters of appointment to NEDs and independent directors - just as it does in appointing employees and executive directors. The letter should:
  - Specify the expectation of the Board from the appointed director;
  - The Board-level committee(s) in which the director is expected to serve and its tasks;
  - The fiduciary duties that come with such an appointment;
  - The term of the appointment;
  - The Code of Business Ethics that the company expects its directors and employees to follow;
  - The list of actions that a director cannot do in the company;
  - The liabilities that accompany such a fiduciary position, including whether the concerned director is covered by any Directors and Officers (D&O) insurance; and
The remuneration, including sitting fees and stock options, if any. The letter stating the terms and conditions of appointment of any NED or independent director should form a part of the disclosure to shareholders at the time of the ratification of his/her appointment or re-appointment to the Board.

The Task Force recommends that the Companies Act, 1956, be amended so that companies have the option of giving a fixed contractual remuneration to NEDs and independent directors, which is not linked to the net profit or lack of it. Therefore, companies should be given the option to choose between: a. Paying a fixed contractual remuneration to its NEDs and IDs, subject to an appropriate ceiling depending on the size of the company; or b. Continuing with the existing practice of paying out upto 1% (or 3%) of the net profits of the stand alone entity as defined in the Companies Act, 1956.

For any company, the choice should be uniform for all NEDs and independent directors, i.e. some cannot be paid a commission of profits while others are paid a fixed amount.

The current limits and constraints on sitting fees and stock options or restricted stock may remain unchanged.

If stock options are granted as a form of payment to NEDs and independent directors, then these must be held by the concerned director until one year of his exit from the Board.

The Task Force recommends that listed companies use the following template in structuring their remuneration to NEDs and independent directors

- Fixed component: This should be relatively low, so as to align NEDs and independent directors to a greater share of variable pay. Typically, these are not more than 30% of the total cash remuneration package.
- Variable Component: Based on attendance of Board and Committee meetings (at least 70% of all meetings should be an eligibility precondition)
• Additional payment for being the chairman of the Board, especially if he / she is a non-executive chairman
• Additional payment for being the chairman of the Audit Committee
• Additional payment for being the chairman of other committees of the Board
• Additional payment for being members of Board committees: Audit, Shareholder Grievance, Remuneration, Nomination.
• The Task Force also recommends that if such a structure (or any structure) of remuneration is adopted by the Board, it should be disclosed to the shareholders in the annual report of the company.
• The Task Force recommends that listed companies should have a Remuneration Committee of the Board.
• The Remuneration Committee should comprise at least three members, majority of whom should be independent directors.
• It should have delegated responsibility for setting the remuneration for all executive directors and the executive chairman, including any compensation payments, such as retirement benefits or stock options. It should also recommend and monitor the level and structure of pay for senior management, i.e. one level below the Board.
• The Remuneration Committee should make available its terms of reference, its role, the authority delegated to it by the Board, and what it has done for the year under review to the shareholders in a separate section of the chapter on corporate governance in the annual report.
• Listed companies should have at least a three-member Audit Committee comprising entirely of non-executive directors with independent directors constituting the majority.
• The Task Force recognised the ground realities of India. Keeping these in mind, it has recommended, wherever possible, to separate the office of the Chairman from that of the CEO.
• If a director cannot be physically present but wants to participate in the proceedings of the board and its committees, then a minuted and signed proceeding of a teleconference or video conference should
constitute proof of his or her participation. Accordingly, this should be treated as presence in the meeting (s). However, minutes of all such meetings or the decisions taken thereat, recorded as circular resolutions, should be signed and confirmed by the director(s) who has / have attended the meeting through video conferencing.

- To empower independent directors to serve as a more effective check on management, the independent directors could meet at regularly scheduled executive sessions without management and before the Board or Committee meetings discuss the agenda.
- The Task Force also recommends separate executive sessions of the Audit Committee with both internal and external Auditors as well as the Management.
- Audit Committee, being an independent Committee, should pre-approve all related party transactions which are not in the ordinary course of business or not on “arms length basis” or any amendment of such related party transactions. All other related party transactions should be placed before the Committee for its reference.
- No more than 10% of the revenues of an audit firm singly or taken together with its subsidiaries, associates or affiliated entities, should come from a single corporate client or group with whom there is also an audit engagement.
- Every company must obtain a certificate from the auditor certifying the firm’s independence and arm’s length relationship with the client company. The Certificate of Independence should certify that the firm, together with its consulting and specialised services affiliates, subsidiaries and associated companies or network or group entities have not / has not undertaken any prohibited non-audit assignments for the company and are independent vis-à-vis the client company, by reason of revenues earned and the independence test are observed.
- The partners handling the audit assignment of a listed company should be rotated after every six years. The partners and at least 50% of the audit engagement team responsible for the audit should be
rotated every six years, but this should be staggered so that on any given day there isn’t a change in partner and engagement manager.

- A cooling off period of 3 years should elapse before a partner can resume the same audit assignment.

- The firm, as a statutory auditor or internal auditor, has to confidentially disclose its networth to the listed company appointing it. Each member of the audit firm is liable to an unlimited extent unless they have formed a limited liability partnership firm or company for professional services as permitted to be incorporated by the relevant professional disciplinary body (ICAI). Even in the case of a limited liability firm undertaking audit in the future, under the new law, the individual auditor responsible for dereliction of duty shall have unlimited liability and the firm and its partners shall have liability limited to the extent of their paid-in capital and free or undistributed reserves.

- The Audit Committee of the board of directors shall be the first point of reference regarding the appointment of auditors. The Audit Committee should have regard to the entire profile of the audit firm, its responsible audit partner, his or her previous experience of handling audit for similar sized companies and the firm and the audit partner’s assurance that the audit clerks and / or understudy chartered accountants or paralegals appointed for discharge of the task for the listed company shall have done a minimum number of years of study of Accounting Principles and have minimum prior experience as audit clerks.

- To discharge the Audit Committee’s duty, the Audit Committee shall:
  - discuss the annual work programme and the depth and detailing of the audit plan to be undertaken by the auditor, with the auditor;
  - examine and review the documentation and the certificate for proof of independence of the audit firm, and
• Recommend to the board, with reasons, either the appointment / re-appointment or removal of the statutory auditor, along with the annual audit remuneration.

• ICAI should appoint a committee to standardise the language of disclaimers or qualifications permissible to audit firms. Anything beyond the scope of such permitted language should require the auditor to provide sufficient explanation.

• The Task Force recommends institution of a mechanism for employees to report concerns about unethical behaviour, actual or suspected fraud, or violation of the company’s code of conduct or ethics policy. It should also provide for adequate safeguards against victimization of employees who avail of the mechanism, and also allows direct access to the Chairperson of the audit committee in exceptional cases.

• The Board, its audit committee and its executive management must collectively identify the risks impacting the company’s business and document their process of risk identification, risk minimisation, risk optimization as a part of a risk management policy or strategy. The Board should also affirm that it has put in place critical risk management framework across the company, which is overseen once every six months by the Board.

• The Task Force suggests that the Government and the SEBI as a market Regulator must concur in the corporate governance standards deemed desirable for listed companies to ensure good corporate governance.

• In the interest of investors, the general public and the auditors, the Task Force recommends that the Government intervenes to strengthen the ICAI Quality Review Board and facilitate its functioning of ensuring the quality of the audit process through an oversight mechanism on the lines of Public Company Accounting Oversight Board (PCAOB) in the United States.

• The Task Force recommends that instances of investigations of serious corporate fraud must be coordinated and jointly investigated. Joint investigations / interrogation by the regulators for example, the
SFIO and the CBI should be conducted in tandem. On the lines of the recommendations of the Naresh Chandra Committee Report on Corporate Audit and Governance, a Task Force should be constituted for each case under a designated team leader and in the interest of adequate control and efficiency, a Committee each, headed by the Cabinet Secretary should directly oversee the appointments to, and functioning of this office, and coordinate the work of concerned department and agencies. Civil recovery for acts of misfeasance, malfeasance, nonfeasance and recovery from the wrongdoers and criminal offences and penalties and punishments should be adjudicated appropriately, without conflicting reports and opinions, and disposed off between 6 to 12 months.

- A provision of confiscation and cancellation of securities of a person who perpetrates a securities fraud on the company or security holders ought to be prescribed for the protection of capital markets.

- Personal penalties should be imposed on directors and employees who seek unjust enrichment and commit offence with such intentions. Such punishments should be commensurate with the wrongful act and be imposed in addition to disgorgement of wrongful gains. Further, non-executive directors cannot be made to undergo the ordeal of a trial for offence of non-compliance with a statutory provision unless it can be established prima facie that they were liable for the failure on part of the company.

- Long term institutional investors, pension funds or infrastructure funds can help to develop a vibrant state of shareholder activism in the country. The oversight by such investors of corporate conduct can be facilitated through internal participation of their nominees as directors or external proceedings for preventing mis-management. Such institutional investors should establish model codes for proper exercise of their votes in the interest of the company and its minority shareholders, at general meetings, analyze and review corporate actions intended in their investee companies proactively and assume
responsible roles in monitoring corporate governance and promoting good management of companies in which they invest.

- The Task Force recommends that media, especially in the financial analytics and reporting business should invest more in analytical, financial and legal rigour and enhance their capacity for analytical and investigative reporting.

**Hampel Committee:**

- We recommend that companies should include in their annual reports a narrative account of how they apply the broad principles.
- Companies should be ready to explain their governance policies, including any circumstances justifying departure from best practice; and those concerned with the evaluation of governance should apply the principles, with common sense, and with due regard to companies individual circumstances. ‘Box ticking’ is neither fair to companies nor likely to be efficient in preventing abuse.
- We intend to produce a set of principles and code of good corporate governance practice, which will embrace Cadbury and Greenbury and our own work. We shall pass this to the London Stock Exchange. We suggest that the London Stock Exchange should consult on this document, together with any proposed changes in the Listing Rules.
- We envisage that the London Stock Exchange will in future make minor changes to the principles and code; and we suggest that the Financial Reporting Council should keep under review the possible need for further studies of corporate governance. Rut we see no need for a permanent Committee on Corporate Governance.
- Executive and non-executive directors should continue to have the same duties under the law.
- Management has an obligation to provide the hoard with a appropriate and timely information and the chairman has a particular responsibility to ensure that all directors are properly briefed. This is essential if the board is to be effective
• An individual should receive appropriate training on the first occasion that he or she is appointed to the board of a listed company, and subsequently as necessary.

• Boards should appoint as executive directors only those executives whom they judge able to take a broad view of the company’s overall interests.

• The majority of non-executive directors should be independent, and boards should disclose in the annual report which of the non-executive directors are considered to be independent. This applies for companies of all sizes.

• There is overwhelming support in the UK for the unitary board, and virtually none for the two tier board.

• We suggest that boards should consider introducing procedures for assessing their own collective performance and that of individual directors.

• We consider that, to be effective, non-executive directors need to make up at least one third of the membership of the board (3.14).

• Separation of the roles of chairman and chief executive officer is to be preferred, other things being equal, and companies should justify a decision to combine the roles.

• Whether or not the roles of chairman and chief executive officer are combined, a senior non-executive director should be identified in the annual report, to whom concerns can be conveyed.

• Companies should set up a nomination committee to make recommendations to the board on all new board appointments.

• All directors should submit themselves for re-election at least every three years, and companies should make any necessary changes in their Articles of Association as soon as possible.

• Names of directors submitted for re-election should be accompanied by biographical details.

• There should be no fixed rules for the length of service or age of non-executive directors: but there is a risk of their becoming less efficient
and objective with length of service and advancing age, and boards should be vigilant against this.

- It may be appropriate and helpful for a director who resigns before the expiry of his term to give an explanation.
- We urge caution in the use of inter-company comparisons and remuneration surveys in setting levels of directors’ remuneration.
- We do not recommend further refinement in the Greenbury code provisions relating to performance related pay. Instead we urge remuneration committees to use their judgement in devising schemes appropriate for the specific circumstances of the company. Total rewards from such schemes should not be excessive.
- We see no objection to paying a non-executive director’s remuneration in the company’s shares, but do not recommend this as universal practice.
- We consider that boards should set as their objective the reduction of directors’ contract periods to one year or less, but recognize that this cannot be achieved immediately.
- We see some advantage in dealing with a director’s early departure by agreeing in advanced on the payments to which he or she would be entitled in such circumstances.
- Boards should establish a remuneration committee, made up of independent non-executive directors, to develop policy on remuneration and devise remuneration packages for individual executive directors.
- Decisions on the remuneration packages of executive directors should be delegated to the remuneration committee; the broad framework and cost of executive remuneration should be a matter for the board on the advice of the remuneration committee. The board should itself devise remuneration packages for non-executive directors.
- The requirements on directors to include in the annual report a general statement on remuneration policy should be retained. We hope that these statements will be made more informative.
• Disclosure of individual remuneration packages should be retained; but we consider that this has become too complicated. We welcome recent simplification of the Companies Act rules; and we hope that the authorities concerned will explore the scope for further simplification.
• We consider that the requirement to disclose details of individual remuneration should continue to apply to overseas based directors of UK companies.
• We support the requirement to disclose the pension implications of pay increases which has been included in the Stock Exchange Listing Rules. We suggest that companies should make clear that transfer values cannot meaningfully be aggregated with annual remuneration.
• We agree that shareholder approval should be sought for new long-term incentive plans; but we do not favour obliging companies to seek shareholder approval for the remuneration report.
• We recommend pension fund trustees to encourage fund managers to take a long view in managing their investments.
• We believe that institutional investors have a responsibility to their clients to make considered use of their votes; and we strongly recommend institutional investors of all kinds, wherever practicable, to vote the shares under their control. But we do not recommend that voting should be compulsory.
• We suggest that the ABI and the NAPF should examine the problem caused by the existence of different and incompatible shareholder voting guidelines.
• We recommend that institutions should make available to clients, on request, information on the proportion of resolutions on which votes were cast and non-discretionary proxies lodged.
• We encourage companies and institutional shareholders to adopt as widely as possible the recommendations in the report Developing a Winning Partnership.
• Companies whose AGMs are well attended should consider providing a business presentation at the AGM, with a question and answer session.

• We recommend that companies should count all proxy votes and announce the proxy count on each resolution after it has been dealt with on a show of hands.

• We hope that the DTI will soon be able to implement their proposals on the law relating to shareholder resolutions, proxies and corporate representatives.

• We consider that shareholders should be able to vote separately on each substantially separate issue; and that the practice of ‘bundling’ unrelated proposals in a single resolution should cease.

• The chairman should, if appropriate, provide the questioner with a written answer to a significant question which cannot be answered on the spot.

• The decision on who should answer questions at the AGM is one for the chairman; but we consider it good practice for the chairmen of the audit, remuneration and nomination committees to be available.

• Companies should propose a resolution at the AGM relating to the report and accounts.

• Notice of the AGM and related papers should be sent to shareholders at least 20 working days before the meeting.

• Companies may wish to prepare a resume of discussion at the AGM and make this available to shareholders on request.

• We commend the practice of some companies in establishing in-house nominees, in order to restore rights to private investors who use nominees; and we note that the DTI and the Treasury are considering changes in the law for the same purpose.

• Each company should establish an audit committee of at least three non-executive directors, at least two of them independent. We do not favour a general relaxation for smaller companies, but recommend
shareholders to show flexibility in considering cases of difficulty on their merits.

- We do not recommend any additional requirements on auditors to report on governance issues, nor the removal of any existing prescribed requirements.
- We suggest that the bodies concerned should consider reducing from 10% the limit on the proportion of total income which an audit firm may earn from one audit client.
- We suggest that the audit committee should keep under review the overarching financial relationship between the company and its auditors, to ensure a balance between the maintenance of objectivity and value for money.
- We recommend that the word ‘effectiveness’ should be dropped from point 4.5 in the Cadbury code, which would then read ‘The directors should report on the company’s system of internal control’. We also recommend that the auditors should report on internal control privately to the directors, which allows for an effective dialogue to take place and for best practice to evolve.
- Directors should maintain and review controls relating to all relevant control objectives, and not merely financial controls.
- Companies which do not already have a separate internal audit function should from time to time review the need for one.
- The requirement on directors to include a ‘going concern’ statement in the annual report should be retained.
- Auditors are inhibited from going beyond their present functions by concerns about the law on liability. Account should be taken of these concerns by those responsible for professional standards and in taking decisions on changes in the law.

**Naresh Chandra Committee**

- Management should provide a clear description in plain English of each material contingent liability and its risks, which should be accompanied by the auditor’s clearly worded comments on the
management’s view. This section should be highlighted in the significant accounting policies and notes on accounts, as well as, in the auditor’s report, where necessary.

- This is important because investors and shareholders should obtain a clear view of a company’s contingent liabilities as these may be significant risk factors that could adversely affect the company’s future financial condition and results of operations.
- For all listed companies, there should be a certification by the CEO (either the Executive Chairman or the Managing Director) and the CFO (whole-time Finance Director or other person discharging this function) which should state that, to the best of their knowledge and belief:
  - They have reviewed the balance sheet and profit and loss account and all its schedules and notes on accounts, as well as the cash flow statements and the Directors’ Report;
  - These statements do not contain any material untrue statement or omit any material fact nor do they contain statements that might be misleading;
  - These statements together present a true and fair view of the company, and are in compliance with the existing accounting standards and / or applicable laws / regulations;
  - They are responsible for establishing and maintaining internal controls and have evaluated the effectiveness of internal control systems of the company; and they have also disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of internal controls, if any, and what they have done or propose to do to rectify these;
  - They have also disclosed to the auditors as well as the Audit Committee, instances of significant fraud, if any, that involves management or employees having a significant role in the company’s internal control systems; and
• They have indicated to the auditors, the Audit Committee and in the notes on accounts, whether or not there were significant changes in internal control and/or of accounting policies during the year.

• Legal provisions must specifically exempt non-executive and independent directors from criminal and civil liabilities under certain circumstances. SEBI should recommend that such exemptions need to be specifically spelt out for the relevant laws by the relevant departments of the Government and independent regulators, as the case may be.

• However, independent directors should 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, defense should not be permitted on the ground that the independent director was unaware of this responsibility.

• It was suggested that SEBI should work towards harmonizing the provisions of clause 49 of the Listing Agreement and those of the Companies Act, 1956.

• The Committee noted that major differences between the requirements under clause 49 and the provisions of the Companies Act, 1956 should be identified. SEBI should then recommend to the Government that the provisions of the Companies Act, 1956 be changed to bring it in line with the requirements of the Listing Agreement.

• It was suggested that companies should inform SEBI/stock exchanges within five business days of the removal/resignation of an independent director, along with a statement certified by the managing director/director/company secretary about the circumstances of such removal/resignation (specifically whether there was any disagreement with the independent director that caused such removal/resignation). Any independent director sought to be removed or who has resigned because of a disagreement with management should have the opportunity to be heard in general meeting.
• The Committee noted that under the existing provisions, companies are required to inform the stock exchanges of any changes in directors. The existing safeguards are adequate and hence no further action is required.

• It was suggested that CEOs / COOs / CFOs should disgorge equity or incentive based compensation, or profits arising from trading in company stock, if a restatement of financial statements is required or if there is any corporate misconduct leading to a financial liability.

• The Committee noted that this was one of the recommendations of the Naresh Chandra Committee. Therefore, the Committee resolved that no further action is required at this stage.

• It was suggested that there must be a cap on the term of office of a non-executive director.

• The Committee noted that persons should 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). [Also refer to recommendation under Section 3.9 of this Report]

• The Committee also noted that it would be a good practice for directors to retire after a particular age. Companies may fix the retirement age at either 65 or 70 years.

• The Committee recommends that the age limit for directors to retire should be decided by companies themselves. Corporate Boards should have an adequate mechanism of self-renewal, as part of corporate governance best practices.

• It was suggested that corporate governance practices followed by companies should be rated using rating models. It was also suggested that companies should be rated based on parameters of wealth generation, maintenance and sharing, as well as on corporate governance.

• The Committee deliberated and noted that corporate governance ratings are desirable, as this will provide a process of independent appraisal. Certain rating agencies have begun work in this area;
however, the process is still in a development phase and may need to be evolved based on future experience.

- The Committee is therefore of the view that for the time being, it should not be mandatory for companies to be rated on corporate governance parameters. However, it should be left to the management of companies to decide whether they want to be rated or not, on corporate governance.

- The Committee considered the views expressed by members on scrutiny of the media, especially the financial press. A code of conduct for the financial media is already prescribed by the Press Council of India. However, verifying adherence to this code of conduct is difficult in the current circumstances. The Committee suggests that it is desirable for SEBI to review this issue in greater detail, keeping in mind issues like transparency and disclosures, conflicts of interest, etc, before making any final rule.

- The Committee noted that SEBI should consider discussing this issue with representatives of the media, especially the financial press.

References:

2. CII Committee Recommendations
5. Kumara Managalam Birla Committee Recommendations on Corporate Governance
6. Narayana Murthy Committee Recommendations on Corporate Governance