CORPORATE GOVERNANCE – RECENT CHANGES IN CLAUSE 49 & INDEPENDENT DIRECTOR

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Corporate Governance initiatives in India:

There have been several major corporate governance initiatives launched in India. The Confederation of Indian Industry (CII) came up with the first voluntary code of corporate governance in 1998. The second was by setting up The Birla Committee on Corporate Governance was constituted by the Securities and Exchange Board of India (SEBI) to promote and raise the Standard of Corporate Governance in respect of listed companies. The third was the Naresh Chandra Committee, which submitted its report in 2002. The fourth was by SEBI, the Narayan Murthy Committee, which also submitted its report in 2002. Based on the recommendations of the 'Committee on Corporate Governance' SEBI has made certain provisions mandatory for listed companies through the route of the Listing Agreement and thus, Clause 49 was revised in August, 2003. After issuance of the August'03 circular, SEBI received representations/suggestions from the corporate/ public on various provisions of the said circular. The Narayan Murthy Committee then considered and deliberated on the suggestions and comments received from corporate/public. Based on the revised recommendations of the Committee, it was decided to further revise the provisions of Clause 49 of the Listing Agreement vide Circular dated 29th October, 04. SEBI has again revised clause 49. This circular is a master circular and supersedes all other earlier circulars issued by SEBI on this subject.

Highlights of the Code are as follows:

1. Boards to have an optimum combination of Executive and Non-Executive Directors with not less than fifty per cent of the Board of directors comprising non-executive directors.
2. All pecuniary relationship or transactions of the non-executive directors with the company should be disclosed in the Annual Report.
3. Companies to set up a qualified and independent Audit Committee and the Company Secretary to act as the Secretary to the said Committee. All members of the Audit Committee shall be non-executive directors with the majority of them being independent, and with at least one director having financial and accounting knowledge. Chairman of the Committee shall be a an independent director.
4. Audit Committee shall have power to investigate any activity within its terms of reference, to seek information from any employee, to obtain outside legal or other professional advice. The Committee will review with the Management, the external and internal auditors, the adequacy of internal control systems, internal audit function including the structure of internal audit department, staffing and seniority of official heading thee department, reviewing the finding s of any internal investigations by the internal auditors, discussions with external auditors, review company's financial and risk management policies and to look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders and creditors.
5. As part of the director's report or as an addition thereto, a Management Discussion and

Analysis Report should for part of the Annual Report tot the Shareholders.

6. Remuneration of NO-Executive Directors to be decided by the Board.
7. Board Meetings to be held at lest four times a year.
8. Shareholders to be provide prescribed information about the appointment of new directors for re-appointment of directors.
9. Companies to provide in Annual Report a separate section on corporate governance.
10. Companies to obtain a compliance certificate from an auditor and to attach it with Directors' Report.
11. Management must disclose to the Board all-important financial and commercial transactions.
12. Information like quarterly results and presentations made by the Company to analysts, shall be put on the company's website or shall be sent in such a form as to enable the stock exchange on which the company's listed to put it on its own website.
13. To expedite the process of share transfers, the Board shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents.

Thus, the key aspects of good corporate governance include transparency of corporate structures and operation; the accountability of manager and the boards to shareholders; and corporate responsibility towards stakeholders.

CORPORATE GOVERNANCE FOR NON LISTED COMPANIES:

For non – listed companies, there is no such requirement now. The J J Irani Committee, which advised the government on the proposed new company law, said that such a requirement for non-listed companies could be consider in due course. Also, there are efforts globally to infuse the spirit of corporate governance in no-listed companies, as they are key player in the total economic activity in a nation. The Organisation for Economic Co-operation and Development (OECD) is also exploring ways to achieve this.

Applicability of Revised Clause 49 of the Listing Agreement:

As per SEBI, revised clause 49 was applicable w.e.f. 01.04.2005. However, the corporate world had raised their concerns that they are not ready for this mainly on account of requirement of independent directors and CEO/CFO certification. SEBI, thus, extended this date to 31st December 2005.

MAJOR CHANGES

(1) INDEPENDENT DIRECTOR:

[Presently, the concept of independent directors is not there in the Companies Act. However, The Act has delegated the administration of some sections relating to listed companies to the capital market regulator-the Securities and Exchange Board of India (SEBI). SEBI, in its circular to stock exchanges in October 2004, has revised the clause 49 of the listing agreement, which mainly deals with independent directors and audit committees.]

The Circular says that a public listed company with an executive chairman on the board should reserve at least half of the board to independent directors. If the chairman is a non–executive, one third would suffice.

The definition of an 'Independent Director' was very limited as per the old clause 49, but in revised circular it is wider An independent director is a non-executive director on the board of a company who has integrity, expertise and the independence to balance the interest of various stake holders. The idea of having them is to bring objectivity to the board decisions and to protect the general interest of the company including that of the minority and small shareholders. Independent directors are expected to improve the corporate governance in a company.

Who cannot be an independent director in a listed company?

The capital market regulator has set eligibility norms for independent directors, which the corporate sector says is too stringent. The Company Affairs Ministry is also considering similar criteria in the proposed new company law. According to SEBI, having a 'pecuniary' relationship with the company or any of its arms, other than receiving the director's remuneration, will be a disqualification. An independent director should bot be related to the promoters or anyone in the senior management position from one level below the board. He should not have been an executive of the company or of its audit, consulting or legal firms in the past three financial years. Besides, owning two percent or more of the block of voting shares or being a service provider to the company, would disqualify one from taking up an independent directorship in a listed company. Also, SEBI says that nominee directors appointed by an institution which has invested in or lent to the company, shall be deemed to be independent directors.

(This is the only official position on the nominee directors today. If the government accepts the Irani Committee recommendations that directors nominated by a financial institution or government are not independent, and Parliament enacts the new companies bill, this view will prevail upon the SEBI definition. The Committee had also said that the minimum period of no-association with the company or tis arms could be one year. The new company law bill is expected to be tabled in Parliament winter session.)

The very purpose of the corporate governance is that the independent director should be independent from the management. He must mot only be independent according the to the definition, but also in thought and action. Mere presence of independent director does not mean that company is well governed.

What are the other corporate governance requirements as per clause 49?

Independent directors play an active role in various committees to be set up by a company to ensure good governance. Listed companies are required to set up audit committees of minimum three directors, on which, two thirds shall be independent directors. The audit committee, chaired by an independent director, shall inspect the company's financial statements and can also recommend replacement of the statutory auditor. At least one independent director on the board of a listed holding company should be on the board of its unlisted subsidiary and can inspect its financial statements. Also, a company's shareholder/investors grievance committee chaired by a no-executive director will look into shareholders complaints like transfer of shares, non-receipt of balance sheet and non-receipt of dividends. Companies are also required to have a separate section on corporate governance in their annual reports and file quarterly compliance report to the stock exchanges. Besides, they are also expected to obtain a certificate from either the auditors or practicing company secretaries on the compliance and send it to all stake holders and the stock exchanges along with the directors' report.

(2) CODE OF CONDUCT FOR BOARD & SENIOR MANAGEMENT:

New Clause 49 requires company to lay down a code of conduct for all board members and senior management of the Company. The annual report of the company shall contain declaration to this effect signed by the CEO. ' Senior Management' mean personnel of the company who are member of its core management team excluding Board of Directors.

(3) CEO/CFO CERTIFICATION:

New Clause 49 requires a CEO or CFO to certify to board that:

Financial Statements do not contain any materially untrue statement

Financial Statement present a true and fair view of the company's affairs and are in compliance with AS &applicable laws and regulations.

No transactions entered into by the company during the year that is fraudulent or illegal

They accept responsibility for establishing and maintaining internal controls

They have disclosed to the auditors and the /audit Committee, deficiencies in the design or operation of internal controls, if any

They have indicated significant changes in internal control, accounting policy & instances of significant fraud, if any to the auditors and the Audit Committee

(4) SUBSIDIARY COMPANIES:

New Clause 49 specifically mention that:

1. At least one independent director on the Board

of Directors of the holding company shall be a director on the Board of Director of material non listed Indian Subsidiary. Material non-listed Indian subsidiary shall mean an unlisted subsidiary, incorporated in India, whose turnover or net worth exceeds 20% of the consolidated turnover or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

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

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

(5) BOARD DISCLOSURE – RISK MANAGEMENT:

In the revised circular, clause 49, disclosure related to Risk Management has tube made mandatory. The Company shall lay down procedures to inform board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive managements controls risk through means of a properly defined framework.

(6) RESPONSIBILITY OF BOARD MEMEBERS:

The Board shall review compliance report of all laws applicable to company, as well as action taken by company to rectify instances of non-compliance. Earlier no such specific mention was here.

OTHER CHANGES

1. As per old clause 49, 4 meetings in one year with a maximum gap of 4 months between two meetings were permitted. But now gap between two meetings has been reduced to 3 months.

2. A director shall not be a member of more than 10 committees or act as a chairman of 5 committees.

3. Audit Committee shall have a minimum of 3 Directors having at least 2/3 to be Independent Directors. At least one Director having financial and accounting expertise. Requirement of all Directors being No Executive Directors is now done away with.

4. Meeting of Audit Committee shall be held for 4 times in a year and gap between two meetings should not exceed 4 months.

5. Audit Committee shall MANDATORILY review the following information:

   >> Management discussion and analysis of financial condition and results of operations

   >> Statement of significant related party transactions, submitted by management

   >> Management letters/letters of internal control weaknesses issued by the statutory auditors

   >> Internal audit reports relating to internal control weaknesses, and

   >> The appointment, removal and terms of remuneration of the Chief Internal Auditor shall be subject to review by the Audit Committee

6. Annual Report to contain disclosure on:

   >> Criteria of making payments to No-executive directors.

   >> No of Shares and convertible instruments held by Non-executive directors

   >> Non-executive directors to disclose their shareholding in the Company, prior to appointment

   >> Notice of General Meeting to contain details of the shareholding of Non-executive directors being appointed at the Meeting.

NON- MANDATORY REQUIREMENT

Revised Clause 49 contains few non-mandatory requirements as well:

1. Independent Directors may have a tenue not

exceeding, in the aggregate, a period of 9 years on the Board of the Company.

2. The Board may set up a remuneration committed to determine the company's policy on remuneration packages for executive directors.

3. A half-yearly declaration of financial performance including summary of the significant events in last six months, may be sent to each household of shareholders.

4. Mechanism for evaluating non-executive Board Members by peer group should be in place. This peer group evaluation could be the mechanism to determine whether to extend/ continue the terms of appointment of non-executive director.

5. Whistle Blower Policy should e made and implemented. This is a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy.

CONCLUSION

Corporate Governance is not merely about preparing 'Corporate Governance Report' to comply with listing agreement. It is not merely forming various committees. Corporate Governance is about ethics in business. Ethics cannot be legislated. It is about transparency, openness and fair play in all aspects of business operation. It has to come through conviction and self-discipline of top management. So companies should adopt Corporate Governance in letter and spirit as well. Government or SEBI can at the most ensure that formalities of Corporate Governance are complied with.

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