

CORPORATE GOVERNANCE VOLUNTARY GUIDELINES 2009



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WEEK**

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**Ministry of Corporate Affairs
Government of India**

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Ministry of Corporate Affairs



Salman Khurshid
Minister of State (I/C)
for Corporate Affairs

FOREWORD

Good corporate governance practices are a sine qua non for sustainable business that aims at generating long term value to all its shareholders and other stakeholders. Some aspects of corporate governance have been enshrined in the law that is administered by the Ministry of Corporate Affairs, SEBI and other sectoral regulators. However, a transparent, ethical and responsible corporate governance framework essentially emanates from the intrinsic will and passion for good governance ingrained in the business entity. The global financial crisis during the recent past, along with some of the large format corporate failures and frauds have convincingly revealed that while the corporate governance super structure in India is fairly durable, there are certain weaknesses that may have their roots in the ethos of individual business entities.

The Ministry of Corporate Affairs has been working towards strengthening of the corporate governance framework through a two pronged strategy. Some aspects which needed to be incorporated in the law have been included in the Companies Bill, 2009 now under examination by Parliament. However, keeping in view the objective of encouraging the use of better practices through voluntary adoption, the Ministry has decided to draft a set of voluntary guidelines which not only serve as a benchmark for the corporate sector but also help them in achieving the highest standard of corporate governance. As we receive feedback from different quarters and gain experience from their adoption, the guidelines can be modified progressively.

During the stakeholders consultation under the aegis of the National Foundation for Corporate Governance, the idea of developing voluntary

guidelines on corporate governance found wide support from all stakeholders. We had the benefit of the report of the Task Force of CII on corporate governance headed by Shri Naresh Chandra and the recommendations of the Institute of Company Secretaries of India for strengthening corporate governance framework. We have also received suggestions and comments from other stakeholders and they have been taken into account while preparing the guidelines.

These guidelines will provide corporate India a framework to govern themselves voluntarily as per the highest standards of ethical and responsible conduct of business. I am confident that adoption of these guidelines will also translate into a much higher level of stakeholders confidence which is crucial to ensure the long term sustainability and value generation by business.

I am reminded of a quotation from the Arthshastra where Chanakya said, "Citizens never support a weak company and birds do not build nests on a tree that does not bear fruits." I hope that these guidelines will be generously adopted by India Inc.

New Delhi
December, 2009



Salman Khurshid
Minister of State (I/C)
for Corporate Affairs



Ministry of Corporate Affairs



R. Bandyopadhyay
Secretary,
Ministry of Corporate Affairs

PREFACE

The Ministry of Corporate Affairs has, in recent times, initiated a number of initiatives for growth and development of the corporate sector. The endeavor of the Ministry is to administer the Companies Act and the activities of the corporate sector with enlightened regulation. With this vision the Ministry is now focusing its concern on a generic issue of tremendous importance not only to corporate India but to the nation as a whole, that of good corporate governance practices, essential to ensure inclusive growth, wherein every section of society enjoys the fruits of the corporate growth. Sound and efficient corporate governance practices are the basis for stimulating the performance of companies, maximizing their operational efficiency, achieving sustained productivity as well as ensuring protection of shareholders' interests.

It was in this context that the National Foundation for Corporate Governance (NFCG) was set up by the Ministry to provide a wide platform to deliberate on issues relating to good corporate governance and sensitize corporate leaders on the importance of good corporate practices.

Good corporate governance is essential for the integrity of corporations, financial institutions and markets. It ensures the health of our economies and their stability. India's corporate sector is diverse in nature. On one hand it consists of multinational corporations, whereas on the other hand a large number of small and medium enterprises drive its growth and provide dynamism to the sector. This interesting mosaic of Corporate India has contributed immensely to the growth of India's economy.

Strong governance standards focusing on fairness, transparency, accountability and responsibility are vital not only for the healthy and vibrant corporate sector growth, as well as inclusive growth of the economy. Since the last decade, good corporate governance practices

have been the subject of random documentation efforts. Keeping in mind that issues of corporate governance may go well beyond the Law and the ambit of legislative or regulatory framework, it has been considered necessary that voluntary guidelines on corporate governance which are relevant in the present context, are prepared and disseminated for consideration and adoption by the corporate sector.

The 'Corporate Governance -Voluntary Guidelines 2009', being proposed for voluntary adoption by the Corporate Sector have taken into account the recommendations of the Task Force set up by Confederation of Indian Industry (CII) under chairmanship of Shri Naresh Chandra in February, 2009 to recommend ways to further improve corporate governance standards and practices. The recommendations of this Task Force were placed on the Ministry's website for wide stakeholders consultations. The feedback, thus received has formed the basis of these voluntary guidelines ,which address a number of current concerns in the area of corporate governance .I am positive that their adoption would result in creating a system of transparent and accountable corporate functioning. These guidelines do not substitute any extant Law or regulation but are essentially for voluntary adoption by the corporates.

While it is expected that more and more corporates should make sincere efforts to consider adoption of these guidelines, there may be genuine reasons for some companies in not being able to adopt them completely. In such a case it is expected that such companies should inform their shareholders about the guidelines which the companies have not been able to apply either fully or partially.

Over a period of time these guidelines will progressively converge towards a framework of best corporate governance standards and practices. After considering the experience of adoption of these guidelines by Indian corporate sector and consideration of relevant feedback and other related issues, the Government may initiate the exercise for review of these guidelines for further improvement after one year.

I look forward to enthusiastic feedback from the corporates on these guidelines.



R. Bandyopadhyay

Secretary,
Ministry of Corporate Affairs

New Delhi
December, 2009



Ministry of Corporate Affairs

PREAMBLE

Good corporate governance practices enhance companies' value and stakeholders' trust resulting into robust development of capital market, the economy and also help in the evolution of a vibrant and constructive shareholders' activism. The Ministry of Corporate Affairs has examined committee reports as well as suggestions received from various stakeholders on issues related to corporate governance. Keeping in mind that the subject of corporate governance may go well beyond the Law and that there are inherent limitations in enforcing many aspects of corporate governance through legislative or regulatory means, it has been considered necessary that a set of voluntary guidelines called "Corporate Governance -Voluntary Guidelines 2009" which are relevant in the present context, are prepared and disseminated for consideration and adoption by corporates.

These guidelines provide for a set of good practices which may be voluntarily adopted by the Public companies. Private companies, particularly the bigger ones, may also like to adopt these guidelines. The guidelines are not intended to be a substitute for or addition to the existing laws but are recommendatory in nature.

While it is expected that more and more corporates should make sincere efforts to consider adoption of the guidelines, there may be genuine reasons for some companies in not being able to do so completely. In such a case it is expected that such companies should inform their shareholders about the reasons for not adopting these guidelines either fully or partially. It is hoped that "India Inc" would respond to these guidelines with keen interest. It is also hoped that by following good governance practices, the Indian corporate sector would be in a better position to enhance not only the economic value of enterprise but also the value for every stakeholder who has contributed in the success of the enterprise, and while doing so, it would be setting the global benchmarks for good corporate governance.

After taking into account the experience of voluntary adoption of these guidelines by the corporates and consideration of relevant feedback, the Government would initiate the exercise for review of these guidelines for further improvement after one year.



Ministry of Corporate Affairs

GUIDELINES

I. BOARD OF DIRECTORS

A. APPOINTMENT OF DIRECTORS

A.1 Appointments to the Board

- i. Companies should issue formal letters of appointment to Non-Executive Directors (NEDs) and Independent Directors - as is done by them while appointing employees and Executive Directors. The letter should specify:
 - The term of the appointment;
 - 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 alongwith accompanying liabilities;
 - Provision for Directors and Officers (D&O) insurance, if any,;
 - The Code of Business Ethics that the company expects its directors and employees to follow;
 - The list of actions that a director should not do while functioning as such in the company; and
 - The remuneration, including sitting fees and stock options etc, if any.
- ii. Such formal letter 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. This letter should also be placed by the company on its website, if any, and in case the company is a listed company, also on the website of the stock exchange where the securities of the company are listed.

A.2 Separation of Offices of Chairman & Chief Executive Officer

To prevent unfettered decision making power with a single individual, there should be a clear demarcation of the roles and responsibilities of

the Chairman of the Board and that of the Managing Director/Chief Executive Officer (CEO). The roles and offices of Chairman and CEO should be separated, as far as possible, to promote balance of power.

A.3 Nomination Committee

- i. The companies may have a Nomination Committee comprising of majority of Independent Directors, including its Chairman. This Committee should consider:
 - proposals for searching, evaluating, and recommending appropriate Independent Directors and Non-Executive Directors [NEDs], based on an objective and transparent set of guidelines which should be disclosed and should, inter-alia, include the criteria for determining qualifications, positive attributes, independence of a director and availability of time with him or her to devote to the job;
 - determining processes for evaluating the skill, knowledge, experience and effectiveness of individual directors as well as the Board as a whole.
- ii. With a view to enable Board to take proper and reasoned decisions, Nomination Committee should ensure that the Board comprises of a balanced combination of Executive Directors and Non-Executive Directors.
- iii. The Nomination Committee should also evaluate and recommend the appointment of Executive Directors.
- iv. A separate section in the Annual Report should outline the guidelines being followed by the Nomination Committee and the role and work done by it during the year under consideration.

A.4. Number of Companies in which an Individual may become a Director

- i. For reckoning the maximum limit of directorships, the following categories of companies should be included:-
 - public limited companies,
 - private companies that are either holding or subsidiary companies of public companies.
- ii. In case an individual is a Managing Director or Whole-time Director in a public company the maximum number of companies in which such an individual can serve as a Non-Executive Director or Independent Director should be restricted to seven.

B. INDEPENDENT DIRECTORS

B.1 Attributes for Independent Directors

- i. The Board should put in place a policy for specifying positive attributes of Independent Directors such as integrity, experience and expertise, foresight, managerial qualities and ability to read and understand financial statements. Disclosure about such policy should be made by the Board in its report to the shareholders. Such a policy may be subject to approval by shareholders.
- ii. All Independent Directors should provide a detailed Certificate of Independence at the time of their appointment, and thereafter annually. This certificate should be placed by the company on its website, if any, and in case the company is a listed company, also on the website of the stock exchange where the securities of the company are listed.

B.2 Tenure for Independent Director

- i. An Individual may not remain as an Independent Director in a company for more than six years.
- ii. A period of three years should elapse before such an individual is inducted in the same company in any capacity.
- iii. No individual may be allowed to have more than three tenures as Independent Director in the manner suggested in 'i' and 'ii' above.
- iv. The maximum number of public companies in which an individual may serve as an Independent Director should be restricted to seven.

B.3 Independent Directors to have the Option and Freedom to meet Company Management periodically

- i. In order to enable Independent Directors to perform their functions effectively, they should have the option and freedom to interact with the company management periodically.
- ii. Independent Directors should be provided with adequate independent office space and other resources and support by the companies including the power to have access to additional information to enable them to study and analyze various information and data provided by the company management.

C. REMUNERATION OF DIRECTORS

C.1 Remuneration

C.1.1 Guiding Principles-Linking Corporate and Individual Performance

- i. The companies should ensure that the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully. It should also be ensured that relationship of remuneration to performance is clear. Incentive schemes should be designed around appropriate performance benchmarks and provide rewards for materially improved company performance. Benchmarks for performance laid down by the company should be disclosed to the members annually.
- ii. Remuneration Policy for the members of the Board and Key Executives should be clearly laid down and disclosed. Remuneration packages should involve a balance between fixed and incentive pay, reflecting short and long term performance objectives appropriate to the company's circumstances and goal.
- iii. The performance-related elements of remuneration should form a significant proportion of the total remuneration package of Executive Directors and should be designed to align their interests with those of shareholders and to give these Directors keen incentives to perform at the highest levels.

C.1.2 Remuneration of Non-Executive Directors (NEDs):

- i. The companies should have the option of giving a fixed contractual remuneration, not linked to profits, to NEDs. The companies should have the option to:
 - (a) Pay a fixed contractual remuneration to its NEDs, subject to an appropriate ceiling depending on the size of the company; or
 - (b) Pay upto an appropriate percent of the net profits of the company.
- ii. The choice should be uniform for all NEDs, i.e. some should not be paid a commission on profits while others are paid a fixed amount.
- iii. If the option chosen is 'i(a)' above, then the NEDs should not be eligible for any commission on profits.

- iv. If stock options are granted as a form of payment to NEDs, then these should be held by the concerned director until three years of his exit from the Board.

C.1.3 Structure of Compensation to NEDs

- i. The companies may use the following manner in structuring remuneration to NEDs:
 - **Fixed component:** This should be relatively low, so as to align NEDs to a greater share of variable pay. These should not be more than one-third of the total remuneration package.
 - **Variable component:** Based on attendance of Board and Committee meetings (at least 75% of all meetings should be an eligibility pre-condition)
 - **Additional variable payment(s)** for being:
 - the Chairman of the Board, especially if he/she is a non-executive chairman
 - the Chairman of the Audit Committee and/or other committees
 - members of Board committees.
- ii. If such a structure (or any similar structure) of remuneration is adopted by the Board, it should be disclosed to the shareholders in the Annual Report of the company.

C.1.4. Remuneration of Independent Directors (IDs)

- i. In order to attract, retain and motivate Independent Directors of quality to contribute to the company, they should be paid adequate sitting fees which may depend upon the twin criteria of Net Worth and Turnover of companies.
- ii. The IDs may not be allowed to be paid stock options or profit based commissions, so that their independence is not compromised.

C.2 Remuneration Committee

- i. Companies should have Remuneration Committee of the Board. This Committee should comprise of at least three

members, majority of whom should be non executive directors with at least one being an Independent Director.

- ii. This Committee should have responsibility for determining the remuneration for all executive directors and the executive chairman, including any compensation payments, such as retirement benefits or stock options. It should be ensured that no director is involved in deciding his or her own remuneration.
- iii. This Committee should also determine principles, criteria and the basis of remuneration policy of the company which should be disclosed to shareholders and their comments, if any, considered suitably. Whenever, there is any deviation from such policy, the justification/reasons should also be indicated/disclosed adequately.
- iv. This Committee should also recommend and monitor the level and structure of pay for senior management, i.e. one level below the Board.
- v. This 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 the Annual Report.

II. RESPONSIBILITIES OF THE BOARD

A. Training of Directors

- i. The companies should ensure that directors are inducted through a suitable familiarization process covering, inter-alia, their roles, responsibilities and liabilities. Efforts should be made to ensure that every director has the ability to understand basic financial statements and information and related documents/papers. There should be a statement to this effect by the Board in the Annual Report.
- ii. Besides this, the Board should also adopt suitable methods to enrich the skills of directors from time to time.

B. Enabling Quality Decision making

The Board should ensure that there are systems, procedures and resources available to ensure that every Director is supplied, in a timely

manner, with precise and concise information in a form and of a quality appropriate to effectively enable/ discharge his duties. The Directors should be given substantial time to study the data and contribute effectively to Board discussions.

C. Risk Management

- i. The Board, its Audit Committee and its executive management should collectively identify the risks impacting the company's business and document their process of risk identification, risk minimization, risk optimization as a part of a risk management policy or strategy.
- ii. The Board should also affirm and disclose in its report to members that it has put in place critical risk management framework across the company, which is overseen once every six months by the Board. The disclosure should also include a statement of those elements of risk, that the Board feels, may threaten the existence of the company.

D. Evaluation of Performance of Board of Directors, Committees thereof and of Individual Directors

The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. The Board should state in the Annual Report how performance evaluation of the Board, its committees and its individual directors has been conducted.

E. Board to place Systems to ensure Compliance with Laws

- i. In order to safeguard shareholders' investment and the company's assets, the Board should, at least annually, conduct a review of the effectiveness of the company's system of internal controls and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems.
- ii. The Directors' Responsibility Statement should also include a statement that proper systems are in place to ensure compliance of all laws applicable to the company. It should follow the "comply or explain" principle.

- iii. For every agenda item at the Board meeting, there should be attached an “Impact Analysis on Minority Shareholders” proactively stating if the agenda item has any impact on the rights of minority shareholders. The Independent Directors should discuss such Impact Analysis and offer their comments which should be suitably recorded.

III. AUDIT COMMITTEE OF BOARD

A. Audit Committee – Constitution

The companies should have at least a three-member Audit Committee, with Independent Directors constituting the majority. The Chairman of such Committee should be an Independent Director. All the members of audit committee should have knowledge of financial management, audit or accounts.

B. Audit Committee – Enabling Powers:

- i. The Audit Committee should have the power to -
 - have independent back office support and other resources from the company;
 - have access to information contained in the records of the company; and
 - obtain professional advice from external sources.
- ii. The Audit Committee should also have the facility of separate discussions with both internal and external auditors as well as the management.

C. Audit Committee - Role and Responsibilities

- i. The Audit Committee should have the responsibility to -
 - monitor the integrity of the financial statements of the company;
 - review the company's internal financial controls, internal audit function and risk management systems;
 - make recommendations in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;

- review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process.
- ii. The Audit Committee should also monitor and approve all Related Party Transactions including any modification/amendment in any such transaction.
- iii. A statement in a prescribed/structured format giving details about all related party transactions taken place in a particular year should be included in the Board's report for that year for disclosure to various stake holders.

IV. AUDITORS

A. Appointment of Auditors

- i. The Audit Committee of the Board should be the first point of reference regarding the appointment of auditors.
- ii. The Audit Committee should have regard to the profile of the audit firm, qualifications and experience of audit partners, strengths and weaknesses, if any, of the audit firm and other related aspects.
- iii. To discharge its duty, the Audit Committee should:
 - 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.

B. Certificate of Independence

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

- ii. The Certificate of Independence should certify that the auditor together with its consulting and specialized services affiliates, subsidiaries and associated companies or network or group entities has not/have not undertaken any prohibited non-audit assignments for the company and are independent vis-à-vis the client company.

C. Rotation of Audit Partners and Firms

- i. In order to maintain independence of auditors with a view to look at an issue (financial or non-financial) from a different perspective and to carry out the audit exercise with a fresh outlook, the company may adopt a policy of rotation of auditors which may be as under:-
 - Audit partner - to be rotated once every three years
 - Audit firm - to be rotated once every five years.
- ii. A cooling off period of three years should elapse before a partner can resume the same audit assignment. This period should be five years for the firm.

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

- i. With a view to ensure proper and accountable audit, there should be clarity between company management and auditors on the nature and amount of information/documents/ records etc and periodicity/frequency for supply/obtaining such information/documents/ records etc.
- ii. In any case the auditor concerned should be under an obligation to certify whether he had obtained all the information he sought from the company or not. In the latter case, he should specifically indicate the effect of such non receipt of information on the financial statements.

E. Appointment of Internal Auditor

In order to ensure the independence and credibility of the internal audit process, the Board may appoint an internal auditor and such auditor, where appointed, should not be an employee of the company.

V SECRETARIAL AUDIT

Since the Board has the overarching responsibility of ensuring transparent, ethical and responsible governance of the company, it is important that the Board processes and compliance mechanisms of the company are robust. To ensure this, the companies may get the Secretarial Audit conducted by a competent professional. The Board should give its comments on the Secretarial Audit in its report to the shareholders.

VI. INSTITUTION OF MECHANISM FOR WHISTLE BLOWING

- i. The companies should ensure the institution of a mechanism for employees to report concerns about unethical behaviour, actual or suspected fraud, or violation of the company's code of conduct or ethics policy.
- ii. The companies should also provide for adequate safeguards against victimization of employees who avail of the mechanism, and also allow direct access to the Chairperson of the Audit Committee in exceptional cases.

