

# GUIDANCE NOTE ON CERTIFICATION OF CORPORATE GOVERNANCE

(As stipulated in Clause 49 of the Listing Agreement)

**[Revised 2009 Edition]**



Celebrating the 60<sup>th</sup> Year of Excellence



**The Institute of Chartered Accountants of India**  
(Set up by an Act of Parliament)  
**New Delhi**

# **Guidance Note on Certification of Corporate Governance**

(As stipulated in Clause 49 of the Listing  
Agreement)

**Revised 2009 Edition**



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# Foreword

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Corporate Governance is a journey and has no destination. The amendments that are brought about in the listing agreement are of a continuous process necessitated by the changing corporate environment and for protecting the interests of various parties to the corporate whether it be stakeholders or shareholders. The regulators are quite conscious of the fact that unless there is a complete transparency of the disclosure of the affairs of the company, corporate governance cannot be guided or controlled.

Securities and Exchange Board of India (SEBI) as the prime regulator of capital market has been taking many proactive initiatives and steps in the arena of corporate governance and statutory auditors play a pivotal role in certification regarding compliance of conditions of corporate governance as stipulated by Clause 49 of the Listing Agreement.

The Institute of Chartered Accountants of India has already come out with a publication on the subject 'Guidance Note on the Certification of Corporate Governance' and it is being revised in accordance with the amendments made by way of SEBI Circulars from time to time. In the year 2008, three circulars have been issued by the regulator by way of amendments to Clause 49.

Judging by the way the changes are coming forth, I am quite hopeful that the role of CA's in the certification process of corporate governance assumes greater dimensions and to enable the members facilitate the process, the revised 2009 edition is brought out incorporating the latest changes.

I wish to record my sincere appreciation to the efforts of the committee under the Chairmanship of CA Charanjot Singh Nanda and other members in deliberating the matter and for bringing out this publication.

New Delhi,  
7<sup>th</sup> April, 2009

**CA. Uttam Prakash Agarwal**  
*President*  
*ICAI*



# Preface

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“Trust” is the major flora and fauna upon on which the corporate epitome is built. Legislation all around the globe strives to achieve the objective of maximizing shareholders wealth in terms of the quality of trust and faith that the shareholders have reposed on the management and towards this the Board has the penultimate responsibility to them by way of more disclosures about corporate governance of the company. The journey of corporate governance has just started and there are miles to go and milestones to achieve.

Securities and Exchange Board of India (SEBI) the prime regulator of capital markets has been ensuring from time to time that corporates need to disclose their working by way of sending a report on the same along with the annual report of the company. Change is a continuous endeavour in any field of activity, and in the field of corporate governance it is fast and rapid.

Taking a cue of the global happenings, interests of the shareholders and others related to a corporate, many changes have been made by way of amendments in Clause 49 of the listing agreement. Such of those changes have been incorporated in the ICAI Guidance Note on Certification of Corporate Governance.

I take this opportunity in thanking my fellow members in the committee for their unstinted support and guidance in bringing out this publication. I also wish to thank CA Sailesh H Bathiya, FCA, Mumbai in assisting for carrying out the necessary changes.

My special thanks to the Hon'ble President of the Institute CA Uttam Prakash Agarwal and to the Vice-President CA Amarjit Chopra, for their support and guidance in all endeavours of the committee.

I also wish to thank the Committee Secretariat, headed by Dr P.T.Giridharan and assisted by CA Rohit Kumar for placing necessary inputs for committee's deliberation.

New Delhi  
2<sup>nd</sup> April, 2009

**CA Charanjot Singh Nanda**  
*Chairman*  
*Committee on Financial Markets and*  
*Investors' Protection*



# **Foreword to the Second Edition**

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Good Corporate Governance is the core process guided by a strategic leadership to provide values with necessary checks and balances. Trust is the foundation on which principles of governance are essentially built and to be observed more by way of self-regulation. However, law generally prescribes principles of corporate governance. In the year 2000, the Securities and Exchange Board of India prescribed certain conditions for compliance of corporate governance in Clause 49 of the Listing Agreement and in October, 2004, it had further introduced various amendments in the said clause. With the revised clause 49 coming into force with effect from 1<sup>st</sup> January, 2006, the scope and application of the requirements on corporate governance have undergone vast changes.

If one looks in entirety, the revised Clause 49 places set of responsibilities and accountability on the part of Board of Directors/CEO/CFO of the company. The statutory auditors have to take into account other reports/certificates in issuance of certificate on compliance of requirements of corporate governance.

What role and responsibilities the audit professionals can envisage in the new requirements of corporate governance? What can be the best course of action during audit of corporate governance? An attempt has been made in this revised Guidance Note, which I hope that the members of the profession will immensely benefit.

I wish to record my sincere appreciation to the efforts of the committee under the Chairmanship of Shri Jayant Gokhale and other members in deliberating the matter in detail and providing guidance to the members to the best extent possible.

New Delhi  
31<sup>st</sup> January, 2006

***Kamlesh S. Vikamsey***  
*President*





## **Preface to the Second edition**

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The Indian economy and Capital Markets have recorded a fantastic and consistent growth, which has brought it considerable global attention. The regulatory authorities as well as legislation have kept pace with these developments and continuously attempted to improve the infrastructure and environment to and bring it in tune with international benchmarks. In doing so the role and responsibility of Chartered Accountants in facilitating best practices in Corporate Governance is significant.

The revised Clause 49 of the Listing Agreement (which has come into effect from 1st January, 2006) has provided a framework for validation and reporting regarding compliance with Corporate Governance requirements. Various duties have been prescribed for the Board, Audit Committee, CEO/CFO etc. and the Auditor is required to issue a certificate in regard to the Compliance of Requirements of Corporate Governance.

The nature of information covered in the report on Corporate Governance is so varied that it is impossible for every facet thereof to be “verified” and audited. However, the statutory auditor has a very onerous responsibility to the stakeholders and regulators in issuing the Certificate of Compliance. It is, therefore, critical that members of our profession approach this task with full awareness of his role. At the same time, this additional role should not be stretched beyond its intended parameters. This Guidance Note is a humble attempt to assist the auditor in performing his role in such certification as the statutory auditor. The deliberations in the Council as well as the Committee brought out clearly that Chartered Accountants will have multifarious roles in the larger context of Corporate Governance. Members of our profession will be involved as Directors, CEO, CFO, and Compliance Officers and in other roles in Financial Management, Control Systems etc. All such persons can benefit from the Guidance provided. It may however, be kept in mind that the Guidance is prepared primarily to assist in performing the duty of certifying compliance with Corporate Governance requirements as prescribed under Clause 49 of the Listing Agreement.

In issuance of the same, there are certain issues such as disclosures on holding company and its relation with subsidiary companies, role and review of information by audit committee, disclosures about risk management and its framework etc., which requires judgment depending upon facts and

circumstances. An attempt has been made to guide the members in the aforesaid areas taking into consideration various points of view that have been extensively debated. These are newly introduced requirements and over a period of time the processes and procedures will evolve and we shall all be enriched by experience.

The Committee on Financial Markets & Investors' Protection in its sincerity and fairness have evolved this revised guidance note after due deliberations and suggestions by the august council. I must place on record my sincere gratitude and appreciation to the valuable time spent by the members of the study group constituted at Mumbai for the purpose. I also place on record my appreciation for the efforts taken by each and every member of the committee namely S/Shri R. S. Adukia, Vice-Chairman, Charanjot Singh Nanda, H. N. Motiwalla, S. Gopalakrishnan, Jitesh Khosla, Sidharth Kumar Birla, Niranjana Saha, Nandkishore Bafna, C. V. Subramanian, Ramu Kennedy, Prabhat K. Maheshwari, M. K. Samantaray, and M. S. Sahoo. I also place on record the invaluable guidance provided by my colleagues in the council and in particular S/Shri S. C. Vasudeva, Harinderjit Singh, Pankaj Jain and others. I am also thankful to S/Shri Shailesh Bhathiya, and Sandeep Maheshwari, FCA, Mumbai for their untiring efforts in reading the basic manuscript and making finer changes.

I am thankful to Shri K. S. Vikamsey, President and Shri T. N. Manoharan, Vice-President for their guidance, technical support and encouragement in bringing out the revised publication.

Mumbai  
27<sup>th</sup> January, 2006

**Jayant Gokhale**  
Chairman

## **Foreword to the First Edition**

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Today, Corporate Governance is looked upon as a distinctive brand and benchmark in the profile of Corporate Excellence and the issue of Corporate Governance has assumed lot of importance in India. Governance is a necessary discipline and proper governance would lead to effectiveness and transparency in the functioning of any corporate entity. Regulatory bodies for the capital market also feel that corporate governance is a necessary requirement for the existence of entity in the market as a whole and as a pre-condition to the listing requirement. The compliance of the conditions of corporate governance has been given top priority by the Securities & Exchange Board of India with the objective of providing better and effective protection to the investors and also to make the market confident and vibrant.

Clause 49 of the Listing Agreement stipulates that a company shall obtain a Compliance Certificate from the Auditors of the Company regarding compliance of the conditions of Corporate Governance and that certificate be annexed with the Directors' Report which is sent annually to all the shareholders of the company. This Certificate should also be sent to the Stock Exchanges along with the annual returns filed by the company. This stipulated requirement reflects the recognition of the role of auditors, and places additional responsibilities on the profession which would go a long way in bridging the expectation gap between the society and the auditor.

In accordance with the SEBI requirement in connection with the issue of compliance certificate by the auditors, The Institute of Chartered Accountants of India is proud to meet this challenging expectation as a social responsibility. This Guidance Note seeks to guide the members of the profession in the proper discharge of this responsibility.

I wish to record my sincere appreciation of the efforts of the Chairman of the Committee on Financial Markets & Investors' Protection, Shri Kamlesh Vikamsey, Shri Pankaj Inderchand Jain, Vice-Chairman of the Committee and other members of the Committee, in bringing out this useful publication in a very short span of time. I also wish to acknowledge my appreciation to Dr. P. T. Giridharan, Secretary, and Committee on Financial Markets &

Investors' Protection who was associated with this work. I am confident that this Guidance Note will immensely help our members in discharging their duties keeping in view the changed scenario and contribute to effective and better protection to the investors.

New Delhi  
3<sup>rd</sup> May 2001

***N. D. Gupta***  
*President*

# Preface to the First Edition

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The codification of **Corporate Governance** and its effective implementation in the true spirit would bring about a sea change in the way in which companies are directed and controlled. It would bring about better transparency in the reporting requirements in the corporate world. The entity with good corporate governance practices would be rewarded in terms of their valuations.

The major code of Corporate Governance implemented in India as well as internationally are in the field of finance. The Chartered Accountants have also been assigned a key role to play in the implementation of the code of Corporate Governance.

The audit committee has been given an important role to play in the implementation of Corporate Governance. One of the members of the audit committee is required to have financial and accounting knowledge. This would encourage companies to induct Chartered Accountants in the board and in the audit committee.

The auditor of an entity would also play a crucial role in the implementation of Corporate Governance. They are required to be present at meetings of the audit committee. This would enable the auditor to effectively communicate with members of the audit committee, majority of whom are independent directors of the board, on matters concerning audit.

The auditor is required to certify the compliance of conditions of Corporate Governance as stipulated in Clause 49 of the Listing Agreement. I am sure this Guidance Note would assist the members in carrying out such certification effectively.

The implementation of code of Corporate Governance is at its nascent stage and as such the practices and disclosure norms would gradually evolve over a period of time. As a consequence the auditors would also progressively evolve their practices in the process of certification of compliance of code of Corporate Governance.

I am thankful to Shri N. D. Gupta, *President* & Shri Ashok Chandak, *Vice President* for their initiatives in this project.

I am grateful to Mr. Pankaj Jain, *Vice Chairman* & Mr. Sunil Goyal, Mr. Vinod Jain, Mr. T. N. Manoharan, Mr. Santhana Krishnan S., my esteemed

colleagues in the Council and members of the Committee on Financial Markets and Investors' Protection for contributing immensely in drafting of this Guidance Note.

I am also thankful to Mr. Anand Rathi, Mr. R L Kabra, Mr. Anil Bafna, Mr. M. K. Agarwal & Mr. R. C. Agarwal, co-opted members of the Committee for their valuable inputs.

Mumbai  
1<sup>st</sup> May 2001

***Kamlesh S. Vikamsey***  
*Chairman*  
Committee on Financial Markets  
& Investors' Protection

# Contents

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|   |         |
|---|---------|
| <i>Foreword</i> .....   |         |
| <i>Preface</i> .....  |         |
| <i>Foreword to the Previous Editions</i> .....                              |         |
| <i>Preface to the Previous Editions</i> .....                               |         |
| <i>Glossary of Terms</i> .....  |         |
| 1. Introduction .....   | 1 - 4   |
| 2. Objective of this Guidance Note .....                                    | 4       |
| 3. General Approach .....   | 5 - 6   |
| 4. Managements' Responsibility.....   | 6 - 7   |
| 5. Auditors' Responsibility .....   | 7       |
| 6. General Principles.....  | 7       |
| 7. Documentation.....   | 8       |
| 8. Verification of Compliance of Conditions of<br>Corporate Governance..... | 8 - 19  |
| <b>I. Board of Directors</b>  |         |
| (A) Composition of Board .....  | 8 - 13  |
| (B) Non-Executive Directors compensation<br>and Disclosures .....           | 13 - 15 |
| (C) Other Provisions as to Board and<br>Committees .....                    | 15 - 18 |
| (D) Code of Conduct.....  | 18 - 19 |
| 9. Audit Committee  |         |
| (A) Qualified and Independent Committee .....                               | 19 - 20 |



|             |     |   |                |
|-------------|-----|---|----------------|
|             | (B) | Meeting of Audit Committee .....  | 20 - 25        |
|             | (C) | Powers of Audit Committee.....  | 26             |
|             | (D) | Role of Audit Committee .....   | 26 - 29        |
|             | (E) | Review of Information by Audit Committee.....   | 29 - 30        |
| <b>III.</b> |     | <b>Subsidiary Companies .....</b>   | <b>30 - 32</b> |
| <b>IV.</b>  |     | <b>Disclosures.....</b>   |                |
|             | (A) | Basis of Related Party Transactions .....   | 32 - 33        |
|             | (B) | Disclosure of Accounting Treatment.....   | 33 - 34        |
|             | (C) | Board Disclosures – Risk Management.....  | 34 - 35        |
|             | (D) | Proceeds from Public issues, Right Issues,<br>Preferential Issues etc. ....                                     | 35 - 36        |
|             | (E) | Remuneration of Directors .....   | 36 - 38        |
|             | (F) | Management.....   | 38 - 39        |
|             | (G) | Shareholders .....  | 39 - 42        |
| <b>V.</b>   |     | <b>CEO/CFO certification.....</b>   | <b>42 - 44</b> |
| <b>VI.</b>  |     | <b>Report on Corporate Governance .....</b>   | <b>44 - 45</b> |
| 10          |     | Management Representation .....   | 45             |
| 11.         |     | Auditors' Certificate .....   | 46 - 47        |
| 12.         |     | Role of Auditor in Audit Committee & Certification<br>of Compliance of Conditions of Corporate Governance ..... | 47 - 48        |

## **APPENDICES**

|                   |   |         |
|-------------------|---|---------|
| <b>Appendix A</b> | List of Thirteen Circulars Issued by SEBI ..... | 49      |
| <b>Appendix B</b> | Disclosure about Risk Management.....           | 50      |
| <b>Appendix C</b> | Auditor's Certificate .....                     | 51 - 52 |

|                   |   |         |
|-------------------|---|---------|
| <b>Appendix D</b> | SEBI Circular dated 29 <sup>th</sup> October, 2004 .....  | 53 - 55 |
| <b>Appendix E</b> | SEBI Circular dated 29 <sup>th</sup> March, 2005 .....  | 56      |
| <b>Appendix F</b> | SEBI Circular dated 13 <sup>th</sup> January, 2006 .....  | 57 - 59 |
| <b>Appendix G</b> | SEBI Definitions on Promoters .....   | 60 - 62 |
| <b>Appendix H</b> | List of Relatives as per Schedule 1A to the<br>Companies Act, 1956.....   | 63      |
| <b>Appendix I</b> | Clause 49 - Corporate Governance –<br>Text of the Full Circular as amended upto<br>23 <sup>rd</sup> October, 2008 ..... | 64 - 70 |
| <b>Appendix J</b> | Information to be placed before Board of<br>Directors .....   | 71 - 74 |
| <b>Appendix K</b> | Format of Quarterly Compliance Report<br>on Corporate Governance.....   | 75 - 77 |

## **ANNEXURES**

|                    |  |           |
|--------------------|--|-----------|
| <b>Annexure 1</b>  | Clause 49 Corporate Governance<br>Provisions .....   | 78 - 94   |
| <b>Annexure 1A</b> | Information to be placed before Board<br>of Directors .....  | 95 - 96   |
| <b>Annexure 1B</b> | Format of Quarterly Compliance Report on<br>Corporate Governance .....   | 97 - 99   |
| <b>Annexure 1C</b> | Suggested List of Items to be included in the<br>Report on Corporate Governance in the Annual<br>Report of Companies ..... | 100 - 103 |
| <b>Annexure 1D</b> | Non-mandatory Requirements .....   | 104 - 105 |



# Glossary of Terms

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|             |   |
|-------------|---|
| <b>AS</b>   | ACCOUNTING STANDARDS                                      |
| <b>AAS</b>  | AUDITING AND ASSURANCE STANDARDS                          |
| <b>CARO</b> | COMPANIES (AUDITOR'S REPORT) ORDER                        |
| <b>CEO</b>  | CHIEF EXECUTIVE OFFICER                                   |
| <b>CFO</b>  | CHIEF FINANCIAL OFFICER                                   |
| <b>CII</b>  | CONFEDERATION OF INDIAN INDUSTRY                          |
| <b>ICAI</b> | INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA               |
| <b>OECD</b> | ORGANIZATION FOR ECONOMIC CO-OPERATION AND<br>DEVELOPMENT |
| <b>RBI</b>  | RESERVE BANK OF INDIA                                     |
| <b>SEBI</b> | SECURITIES AND EXCHANGE BOARD OF INDIA                    |
| <b>SCRA</b> | SECURITIES CONTRACTS (REGULATION) ACT                     |



# 1. Introduction

**1.1 Corporate Governance** is a system by which companies are directed and governed by the management in the best interests of the stakeholders and others by ensuring better management, greater transparency and timely financial reporting. The three key aspects of corporate governance includes: inter-alia, accountability, transparency and equality of treatment for all stakeholders. Since the pivotal role in any system of corporate governance is performed by the Board of Directors, they are primarily accountable and responsible for governance of their companies.

**1.2** A number of reports and codes of Corporate Governance have been published internationally. Notable among them are the Report of Cadbury Committee, the Report of Greenbury Committee, the Combined Code of the London Stock Exchange, the OECD Code on Corporate Governance, the Blue Ribbon Committee on Corporate Governance, the Hampel Committee on Corporate Governance and the Review of the Role and Effectiveness of Non-executive Directors published by the Department of Trade and Industry, U.K.

**1.3** In the Indian scenario, the Confederation of Indian Industry (CII) published Desirable Corporate Governance – A Code, in April 1988 which was followed by the setting up of a committee by The Securities and Exchange Board of India (hereinafter referred to as "SEBI") in May 1999 under the Chairmanship of Kumar Mangalam Birla to formulate the code of Corporate Governance. Based on the report of this committee and developments thereafter, SEBI has issued thirteen Circulars<sup>1</sup> which give a detailed provisions of Corporate Governance.

**1.4** The Reserve Bank of India constituted an Advisory Group on Corporate Governance, which submitted its report in April 2001. Thereafter, the then Ministry of Finance and Company Affairs constituted a Committee on Corporate Audit and Governance under the Chairmanship of Naresh Chandra, which submitted its

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<sup>1</sup> List of thirteen circulars given in Appendix A at Page No. 49

report in November 2002. Currently the Ministry of Corporate Affairs is considering further reforms in Corporate Governance through the Companies Bill, 2008 which was introduced in the Parliament on 13 October, 2008.

In its constant endeavor to improve the framework of Corporate Governance in India in line with the needs of a dynamic market, SEBI constituted a Committee on Corporate Governance under the Chairmanship of N. R. Narayana Murthy, which submitted its report in February 2003. Based on its recommendations and public comments received on the report, SEBI in exercise of the powers conferred by section 11 (1) of the Securities and Exchange Board of India Act, 1992 read with section 10 of the Securities Contracts (Regulation) Act 1956, revised the Clause 49 of the Listing Agreement as per Circular SEBI/CFD/DIL/CG/1/2004/12/10 dated 29 October, 2004<sup>2</sup>.

**1.5** The SEBI Circular dated 29 October, 2004 is the Master Circular and has replaced all the earlier Circulars issued on Clause 49 of the Listing Agreement. Further through another Circular SEBI/CFD/DIL/CG/1/2005/29/3 dated 29 March, 2005<sup>3</sup> SEBI extended the date of ensuring compliance with the revised Clause 49 (i.e. Circular dated 29 October, 2004) to December 31 2005. Subsequently, SEBI vide Circular No. SEBI/CFD/DIL/CG/1/2006/13 dated 13 January, 2006<sup>4</sup> made further clarificatory amendments to remove certain operational difficulties. In addition to the above, SEBI made further amendments in Clause 49 by the following circulars:

- a) SEBI/CFD/DIL/LA/4/2007/27/12 dated 27 December, 2007 for amendments to Equity Listing Agreement<sup>5</sup> and
- (b) SEBI/CFD/DIL/CG/1/2008/08/04 dated 8 April, 2008 for amendments in Clause 49 to the Listing Agreement<sup>6</sup>

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<sup>2</sup> Reproduced in Appendix D at Page Nos. 53 - 55

<sup>3</sup> Reproduced in Appendix E at Page 56

<sup>4</sup> Reproduced in Appendix F at Page 57 - 59

<sup>5</sup> Reproduced in Appendix I at Page No 64 - 70

<sup>6</sup> Reproduced in Appendix J at Page Nos 71 - 74

## **Guidance Note on Certification of Corporate Governance**

**1.6** As per the SEBI Circular dated October 29, 2004 the provisions of revised Clause 49 shall be implemented as per the schedule of implementation given below:

- (a) For entities seeking listing for the first time, at the time of seeking in principle approval for such listing.
- (b) For existing listed entities which were required to comply with revised Clause 49 i.e. those having a paid up share capital of Rs. 3 crores and above or net worth of Rs. 25 crores or more at any time in the history of the company, by April 1, 2005.

Companies complying with the provisions of the existing Clause 49 at present (issued vide circulars dated 21st February, 2000, 9th March 2000, 12th September 2000, 22<sup>nd</sup> January, 2001 16th March 2001 and 31st December 2001) shall continue to do so till the revised Clause 49 of the Listing Agreement is complied with or till March 31, 2005 whichever is earlier. Subsequently, the date for ensuring compliance with the revised Clause 49 of the listing agreement was extended upto December, 31, 2005 and the revised Clause 49 of the listing agreement came into effect on January 1, 2006.

**1.7** The requirements of revised Clause 49 (hereinafter referred as Clause 49) for Corporate Governance are divided into mandatory<sup>7</sup> and non-mandatory requirements.<sup>8</sup> The non-compliance of any mandatory requirement of Clause 49 with reasons thereof should be specifically highlighted. The extent to which the non-mandatory requirements have been adopted / complied with should be mentioned in the Corporate Governance Report.

**1.8** As per Clause 49 VII (1) of the Listing Agreement, a company is required to obtain a certificate either from the auditors of the company or practising company secretaries regarding compliance of requirements of Corporate Governance. This certificate is required to be annexed with the Directors' Report, which is sent annually to all the shareholders of the company. Further, the same

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<sup>7</sup> See Annexure I at Page Nos. 78 - 94

<sup>8</sup> See Annexure ID at Page Nos.. 104 - 105



certificate is also required to be sent to the stock exchange (s) along with the Annual Report filed by the company. The expression “auditors of the company” would mean the auditors appointed to audit the financial statements of the company under the Companies Act, 1956.

## **2. Objective of the Guidance Note**

**2.1** This Guidance Note is intended to provide guidance to auditors for certification of the compliance of requirements of Corporate Governance as stipulated in Clause 49 of the Listing Agreement between the Stock Exchange and the auditee company (hereinafter referred to as “Listing Agreement”):

**2.2(a)** It is the management’s responsibility to ensure the implementation of the requirements of corporate governance as stipulated in Clause 49 of the Listing Agreement.

**(b)** The Auditor’s responsibility is to certify compliance of requirements of corporate governance as stipulated in Clause 49 of the Listing Agreement.

**(c)** The Auditor obtains sufficient understanding of the implementation of the requirements of corporate governance as stipulated in Clause 49 of the Listing Agreement.

**2.3** This Guidance Note is intended to:

- ❑ assist in clarifying the respective responsibilities of the management and the auditor
- ❑ suggest to the auditor what he is to inquire from the management
- ❑ provide guidance on the verification procedure for the compliance of requirements of corporate governance
- ❑ assist in the issuance of the required certificate
- ❑ outline the circumstances in which the auditor may issue a disclaimer or an adverse or qualified certificate.

### **3. General Approach**

For issuance of Certificate on Compliance of requirements of Corporate Governance as stipulated in Clause 49 of the Listing Agreement, the following general approach may be kept in mind:

**3.1** As per the SEBI circular dated 13<sup>th</sup> January 2006 the revised Clause 49 of the listing agreement came into effect from January, 1<sup>st</sup>, 2006. Therefore, for the reporting period as on 31<sup>st</sup> March, 2006, the auditor has to ensure that for the transition period, reporting requirements have to be split into two parts i.e., one for the period ending 31<sup>st</sup> December, 2005, for which the compliance of requirements would be as per the requirements prior to the revised clause and for the period beginning from 1<sup>st</sup> January, 2006 to 31<sup>st</sup> March, 2006, the certificate would be for compliance of requirements as stipulated in the SEBI circular dated 29<sup>th</sup> October, 2004. The SEBI Circular No SEBI/CFD/DIL/ CG/1/2006/13/1 dated 13<sup>th</sup> January, 2006 has reiterated this position.

**3.2** While determining the optimum combination of Executive and Non-executive Directors, the auditor has to keep in mind that since the terms 'executive' and 'non-executive' are not defined in Clause 49, he has to refer to the minutes of the Board.

**3.3** While determining the number of independent and non-independent directors in the Board of Directors, the auditor has to keep in mind the different limits prescribed in Clause 49 (1A) (i) and (ii). Clause 49 I (A) (i) provides that the Board of Directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the Board of Directors comprising of non-executive directors. Clause (ii) provides that where the Chairman of the Board is a Non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors. Further, where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors. This requirement prescribed by SEBI

Vide Circular No. SEBI/CFD/DIL/CG/1/2008/08/04 dated April 8, 2008 by way of amendment to Clause 49.

**3.4** The above clause provides for three sets of limit for the composition of independent directors in the Board where the Chairman is either a non-executive director or an executive Director.

**3.5** For arriving at the number of independent directors in either of the case, any fraction thereof should be rounded off to the next integer as the words used in the clause is “not less than” and “at least”.

**3.6** While planning and performing audit procedures and for evaluating and reporting its results, the auditor should recognize that non-compliance by the company with laws and regulations may materially affect the financial statements. Also it should be noted that as per AAS 21, (Consideration of Laws and Regulations in an Audit of Financial Statements), compliance with the Laws and Regulations is the responsibility of the management.

**3.7** For the purpose of verification of compliance of requirements of Corporate Governance, the auditor would be required to review the policies prescribed, the process and procedures followed, and the documentation in this regard.

**3.8** While issuing the certificate on compliance of requirements of Corporate Governance as stipulated in Clause 49, the auditor has to observe the timing and procedure which are generally followed in regard to obtaining the financial statements as approved by the Board, draft Directors’ Report, draft report on corporate governance<sup>9</sup> and issuance of auditor’s report.

## **4. Management’s Responsibility**

Managements’ responsibility for conducting its business implicitly requires it to take reasonable steps to ensure the implementation of the requirements of corporate governance as stipulated in Clause 49 of the Listing Agreement. Under its terms, a company is statutorily bound to implement the requirements of Clause 49 of

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<sup>9</sup> See Annexure – IB at Page No. 97 - 99

## ***Guidance Note on Certification of Corporate Governance***

the Listing Agreement. This flows from provision of Section 21 of the Securities Contracts (Regulation) Act, 1956(SCRA). Section 23 of SCRA, 1956 provides for stringent penalties<sup>10</sup> for non-compliance of Section 21 of the Act.

### **5. Auditor's Responsibility**

**5.1** The Auditor's responsibility in certifying compliance of requirements of corporate governance relate to verification and certification of factual implementation of requirements of corporate governance as stipulated in Clause 49 of the Listing Agreement. Such verification and certification is neither an audit nor an expression of opinion on the financial statements of the company.

**5.2** The certificate from the Auditor as regards compliance of requirements of corporate governance is neither an assurance about the future viability of the company nor the efficiency or effectiveness with which the management has conducted the affairs of the company.

### **6. General Principles**

**6.1** The Standards set out in Statements on Auditing and Assurance Standards (hereinafter referred to as AAS) would be applicable in the performance of certification of requirements of corporate governance by the Auditor, to the extent relevant.

**6.2** As in the case of other professional assignments, in certification of compliance of requirements of corporate governance, the Auditor should comply with the "Code of Ethics" issued by the Institute of Chartered Accountants of India.

**6.3** The Auditor should conduct verification of compliance of requirements of corporate governance as stipulated in Clause 49 of the Listing Agreement in accordance with this Guidance Note.

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<sup>10</sup> Presently, the non-compliance with the conditions of the listing agreement attract a penalty, punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees, or with both.

## 7. Documentation

The auditor should document matters, that are important in providing evidence to support the certificate of factual findings in accordance with AAS 3 on “Documentation”.

## 8. Verification of Compliance of Conditions of Corporate Governance

8.1 The verification of compliance of the requirements of Corporate Governance is discussed hereunder with reference to various paragraphs of Clause 49 of the Listing Agreement.

### 8.2 Board of Directors

#### 1. (A) Composition of Board

- (i) *The Board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors.*
- (ii) *Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors.*

*Provided that where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.<sup>11</sup>*

*Explanation-For the purpose of the expression “related to any promoter” referred to in sub-clause (ii):*

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<sup>11</sup> SEBI Circular No. SEBI/CFD/DIL/CG/1/2008/08/04 dated April 8, 2008 by modification to Clause 49.

## **Guidance Note on Certification of Corporate Governance**

- a. *If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;*
  - b. *If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.<sup>12</sup>*
- (iii) *For the purpose of the sub-clause (ii), the expression 'independent director' shall mean a non-executive director of the company who:*
- (a) *apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;*
  - (b) *is not related to promoters or persons occupying management positions at the board level or at one level below the board;*
  - (c) *has not been an executive of the company in the immediately preceding three financial years;*
  - (d) *is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:*
    - (i) *the statutory audit firm or the internal audit firm that is associated with the company, and*
    - (ii) *the legal firm(s) and consulting firm(s) that have a material association with the company.*
  - (e) *is not a material supplier, service provider or customer or a lessor or lessee of the company, which*

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<sup>12</sup> SEBI/CFD/DIL/CG/2/2008/23/10 October 23, 2008

*may affect independence of the director, and*

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

*(g) is not less than 21 years of age<sup>13</sup>.*

**Explanation:** For the purposes of the sub-clause (iii):

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

*(b) “Senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.*

*(c) “Relative” shall mean “relative” as defined in section 2(41) and section 6 read with Schedule IA of the Companies Act, 1956.*

*(iv) Nominee directors appointed by an institution, which has invested in or lent to the company shall be deemed to be independent directors.*

**Explanation:** *“Institution” for this purpose means a public financial institution as defined in Section 4A of the Companies Act, 1956 or a “corresponding new bank” as defined in section 2(d) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 [both Acts].”*

**[Clause 49 I (A)]**

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<sup>13</sup> SEBI Circular No. SEBI/CFD/DIL/CG/1/2008/08/04 dated April 8, 2008 by modification to Clause 49.

## **Guidance Note on Certification of Corporate Governance**

**8.3** The auditor should ascertain throughout the reporting period whether the Board of Directors comprises not less than 50% of the directors who are non-executive directors. The expressions “executive directors” and “non-executive directors” have not been explained in Clause 49. The non-executive directors are directors who are not involved in day-to-day management of the company. However, the expression “independent director” has been explained in the Clause 49 I (A) (iii) of the Listing Agreement. The minutes of the Board in this regard should be verified by the auditor for ascertaining as to who could be an independent director. It may further be noted that nominee directors appointed by an institution<sup>14</sup>, which has invested in or lent to the company shall be deemed to be independent directors. For the purpose of test of determining “independence” of a director, reference may be made to Clause 49 I (A) (iii). It may, however, be noted that in the ultimate analysis, apart from the above referred objective tests, judgment based on facts of the case may also be kept in mind. A non-executive director may or may not be independent. However, an executive director cannot be considered as independent director. Also an independent director should not be related to promoters or persons occupying management positions at the Board level or at one level below the Board. The minutes of the Board of Directors’ should be verified to ascertain whether a director is an executive director or a non-executive director.

**8.4** The auditor should also verify that where the Chairman of the Board is a non-executive director, at least 1 / 3<sup>rd</sup> of the Board should comprise of independent directors. In case the Chairman is an executive director, at least half of the Board should comprise of independent directors. Also *where the non-executive Chairman is a promoter of the company or is related to any promoter of the company or person occupying management positions at the Board level or at one level below the Board*, at least one-half of the Board of the company shall consist of independent directors.<sup>15</sup> For determining the number of requisite independent directors and / or non-executive directors, the fraction, if any, in number of one-half or one-third as the case may be should be rounded off. Since the terms in this clause refer to ‘not less than’ and ‘at least’, it would

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<sup>14</sup> See Explanation to Clause 49 I(A)(iv) given above in page No. 10

<sup>15</sup> SEBI Circular NO. SEBI/CFD/DIL/CG/1/2008/08/04 dated April 8, 2008



be appropriate to compute the number by rounding off any fraction to the next integer. For example, in a Board headed by non-executive Chairman and comprising of six other directors (i.e., seven directors) the independent directors should be three or more.

**8.5** Annual Declaration by directors to the Board of Directors may be examined for this purpose. If the Board has followed any particular procedure(s) to ascertain independence of directors, the Auditor should examine the same. Effect of changes in the composition of the Board and / or its Chairman and its impact on compliance throughout the reporting period may also be looked into.

**8.6** It is to be noted that an independent non-executive director apart from receiving remuneration should not have any material pecuniary relationship or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associates which may affect the independence of the director.

**8.6.1** Since the meaning of the term 'associate' is not clear from Clause 49, a reference may be made to AS 23 (Accounting for Investments in Associates in Consolidated Financial Statements), which defines an associate as an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor. However, for the purpose of sub-clause (iii) only an associate, which is a company should be considered.

**8.6.2** The term 'promoter' has been defined in Explanation I in paragraph 6.8.3.2 of the SEBI (Disclosure and Investor Protection) Guidelines, 2000<sup>16</sup>. The term has also been defined differently in Regulation 2(1)(h) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 1997<sup>17</sup>. Further the term 'promoter' has also been defined in Clause 4 (12) of the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999<sup>18</sup>.

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<sup>16</sup> See Appendix G at Page Nos 60 - 62

<sup>17</sup> See Appendix G at Page No 60 - 62

<sup>18</sup> See Appendix G at Page Nos 60 - 62

## **Guidance Note on Certification of Corporate Governance**

**8.6.3** Also, such independent director should not be a material supplier, service provider or customer or a lessor or lessee of the company, which may affect the independence of the director and should not also be a substantial shareholder of the company which means, he should not own 2% or more of the block of voting shares. For this purpose, reference can be made to Section 299 of the Companies Act, 1956.

**8.6.4** According to Section 2(41) of the Companies Act, 1956, 'relative' means, with reference to any person, any one who is related to such person in any of the ways specified in Section 6, and no others. Further, according to Section 6 of the Companies Act, 1956, a person shall be deemed to be a relative of another if, and only if:

- (a) they are members of a Hindu Undivided Family; or
- (b) they are husband and wife; or
- (c) the one is related to the other in the manner indicated in schedule 1A<sup>19</sup>.

### **8.7 (B) Non-executive Directors' Compensation and Disclosures**

- (i) *All fees / compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in general meeting. The shareholders' resolution shall specify the limits for the maximum number of stock options that can be granted to non-executive directors, including independent directors, in any financial year and in aggregate.*

*<sup>20</sup>Provided that the requirement of obtaining prior approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the*

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<sup>19</sup> See Appendix H at Page No 63

<sup>20</sup> Inserted by SEBI Circular dt 13<sup>th</sup> January, 2006 – See Appendix F at Page Nos.. 57 - 59

*Companies Act, 1956 for payment of sitting fees without approval of the Central Government.*

**[Clause 49 I (B)]**

#### **8.8 The auditor**

- ❑ should ascertain from the minutes of the Board of Directors' meeting, shareholders' meetings, relevant agenda papers, notices, explanatory statements, etc., whether remuneration of non-executive directors has been decided by the Board of directors and previous approval of the shareholders in the general meeting has been obtained.
- ❑ May note that no approval from the Central Government is required as long as the remuneration is within the limits prescribed in Schedule XIII to the Companies Act, 1956.
- ❑ May note that in regard to sitting fees payable to non-executive directors, prior approval in the general meeting will not be required if made within the limits prescribed under the Companies Act, 1956.
- ❑ Should also verify whether the remuneration is in compliance with Section 198, 309, 314, 349 and 350 of the Companies Act, 1956 and whether the stock options that are granted to the non-executive directors are in accordance with SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.
- ❑ Should further refer to the Articles of Association of the Company wherever applicable.
- ❑ Should examine the report of the Board of directors on Corporate Governance to be included in the annual report of the company and ascertain whether the same contains the disclosures required for remuneration to non-executive directors. The auditor should correlate this data with what is contained in the financial statements.

**8.9** Since Clause 49 I (B) refers to stock options that can be granted to non-executive directors, reference may be made to

## **Guidance Note on Certification of Corporate Governance**

ICAI Guidance Note on Accounting for Employee Share-based Payments which defines the following terms:

- ❑ Employee Stock Option plan is a plan under which the enterprise grants Employee Stock Options.
- ❑ Employee Stock Option is a contract that gives the employees of the enterprise the right, but not the obligation, for a specified period of time, to purchase or subscribe to the shares of the enterprise at a fixed or determinable price.
- ❑ Employee Stock Purchase Plan is a plan under which the enterprise offers shares to its employees as part of a public issue or otherwise.

**8.10** Where application of this clause requires the value of ESOP to be determined, the services of an expert may have to be utilized. In this regard, reference may be made to AAS 9 dealing with 'Using the Work of an Expert'

### **8.111 (c) Other provisions as to Board and Committees**

- (i) The board shall meet at least four times a year, with a maximum time gap of four months<sup>21</sup> between any two meetings. The minimum information to be made available to the board is given in Annexure– I A<sup>22</sup>.*
- (ii) A director shall not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director. Furthermore it should be a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.*

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<sup>21</sup> Substituted in place of 'three months' by SEBI Circular dt. 13<sup>th</sup> January, 2006 – See Appendix F at Page Nos. 57 - 59

<sup>22</sup> Annexure 1 A given at Page Nos. 95 - 96

**Explanation:**

1. *For the purpose of considering the limit of the committees on which a director can serve, all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies and companies under Section 25 of the Companies Act shall be excluded.*
  2. *For the purpose of reckoning the limit under this sub-clause, Chairmanship / membership of the Audit Committee and the Shareholders' Grievance Committee alone shall be considered.*
- (iii) *The Board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.*
- (iv) *An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director within a period of not more than 180 days from the day of such resignation or removal as the case may be:*

Provided that where the company fulfills the requirements of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director within the period of 180 days shall not apply.<sup>23</sup>

**[Clause 49 I (C)]**

**8.12**Section 285 of the Companies Act, 1956 is reproduced hereunder:

**“S.285. Board to meet at least once in every three calendar months-** *In the case of every company, a meeting of*

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23 SEBI Circular NO. SEBI/CFD/DIL/CG/1/2008/08/04 dated April 8, 2008

## **Guidance Note on Certification of Corporate Governance**

*its Board of Directors shall be held at least once in every three months and at least four such meetings shall be held in every year.*

***Provided** that the Central Government may, by notification in the Official Gazette, direct that the provisions of this section shall not apply in relation to any class of companies or shall apply in relation thereto subject to such exceptions, modifications or conditions as may be specified in the notification”.*

**8.13** Clause 49 and Section 285 stipulate that the Board meeting shall be held at least four times a year. The further requirement of Clause 49 is that the maximum time gap between any two meetings should not exceed four<sup>24</sup> months. The requirement under the Companies Act, 1956 is that the Board meeting would be held at least once in every three months.

**8.14** The auditor should ascertain from the minute's book of the Board meetings whether meetings were held at least four times a year, with a maximum time gap of four<sup>25</sup> months between any two meetings. The auditor should also ascertain whether minimum information was made available to the Board, as given in Annexure – 1C<sup>26</sup> to Clause 49 of the Listing Agreement.

**8.15** The auditor should also ascertain that a director of the Company is not a member of more than ten committees or is acting as chairman of more than five committees across all companies in which he is a director. A suitable declaration from the management and / or director should be obtained to this effect. This information should be verified from the mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies as well as from the changes notified by every director when they take place. The Explanation 1 to Clause 49 (1) (C) (ii) clarifies that the limit of the committees on which a director can serve would comprise all public limited companies, whether listed or not and excluding

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<sup>24</sup> Substituted in place of 'three months' by SEBI Circular dt. 13<sup>th</sup> January, 2006 – See Appendix F at Page Nos. 57 - 59

<sup>25</sup> *ibid.*

<sup>26</sup> At Page Nos 100 - 103

private limited companies, foreign companies and companies which are granted license under section 25 of the Companies Act, 1956. Further Explanation 2 clarifies that only two committees namely Audit Committee and Shareholders' Grievance Committee shall be considered for the purpose of limit.

**8.16** For the purpose of reviewing compliance reports of all laws applicable to the company, the said reports prepared by the company as well as steps taken by the company to rectify instances of non-compliance, the auditor should take into consideration the AAS 21, dealing with consideration of Laws and Regulations in Audit of Financial Statements. It is the management's responsibility to ensure that company operations are conducted in accordance with Laws and Regulations. The responsibility for the prevention and detection of non-compliance rests with the management. The auditor's responsibility is limited to verifying that management has taken suitable steps and put in place policies and procedures to ensure compliance with laws and regulations and to detect deviation from such procedures.

**8.17I (D) Code of Conduct**

- (i) *The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.*
- (ii) *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 by the CEO.*

**Explanation:** *For this purpose, the term "senior management" shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.*

**[Clause 49 I (D)]**

## **Guidance Note on Certification of Corporate Governance**

**8.18** The auditor should ascertain whether the Board of Directors of the company has laid down a code of conduct for all its members and senior personnel of the company and obtain a copy of the same. He should also verify whether all members and senior management personnel have affirmed compliance with the code on an annual basis and whether the code has been posted on the company's website.

## **9. Audit Committee**

### **9.1 II (A) Qualified and Independent Audit Committee**

*A qualified and independent audit committee shall be set up giving the terms of reference subject to the following:*

- (i) The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.*
- (ii) All members of audit committee shall be financially literate and at least one member shall 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.*

- (iii) The Chairman of the Audit Committee shall be an independent director;*



- (iv) *The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;*
- (v) *The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;*
- (vi) *The Company Secretary shall act as the secretary to the committee.*

**[Clause 49-II (A)]**

### **9.2 II (B) Meeting of Audit Committee**

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

**[Clause 49 II (B)]**

**9.3** Section 292A of the Companies Act, 1956 relating to Audit Committee is reproduced herein below:

#### **“Section 292A – Audit Committee**

- (1) *Every public company having paid-up capital of not less than five crores of rupees shall constitute a committee of the Board known as “Audit Committee” which shall consist of not less than three directors and such number of other directors as the Board may determine of which two-thirds of the total number of members shall be directors, other than managing or whole-time directors.*

## **Guidance Note on Certification of Corporate Governance**

- (2) *Every Audit Committee constituted under sub-section (1) shall act in accordance with terms of reference to be specified in writing by the Board.*
- (3) *The members of the Audit Committee shall elect a chairman from amongst themselves.*
- (4) *The annual report of the company shall disclose the composition of the Audit Committee.*
- (5) *The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.*
- (6) *The Audit Committee should have discussions with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half-yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems.*
- (7) *The Audit Committee shall have authority to investigate into any matter in relation to the items specified in this section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice, if necessary.*
- (8) *The recommendations of the Audit Committee on any matter relating to financial management, including the audit report, shall be binding on the Board.*
- (9) *If the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefor and communicate such reasons to the shareholders.*
- (10) *The chairman of the Audit Committee shall attend the annual general meetings of the company to provide any clarification on matters relating to audit.*

(11) *If a default is made in complying with the provisions of this section, the company, and every officer who is in default, shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to fifty thousand rupees, or with both”.*

The comparative chart showing the requirements under Clause 49 and Section 292A relating to audit committee is tabulated herein below:

| <b>Clause 49 of the Listing Agreement</b>   | <b>Section 292A of the Companies Act, 1956</b>  |
|---|---|
| <p>a) All companies seeking listing for the first time, at the time of seeking in principle approval for such listing and</p> <p>(b) All existing listed companies with a paid-up capital of Rs.3 Crores and above or net worth of Rs. 25 crores or more at any time in the history of the company are required to set up an audit committee.</p> | <p>1. Every public company having paid-up capital of not less than five crores of rupees shall constitute an audit committee immediately on the enactment of Companies (Amendment) Act, 2000, i.e. with effect from 13<sup>th</sup> December, 2000.</p> |
| <p>2. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.</p>   | <p>2. The audit committee shall have minimum three directors of which two-third of the total number of such directors shall be directors other than managing or whole-time directors.</p>   |
| <p>3. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.</p>   | <p>3. No such reference is contained in the Companies Act, 1956.</p>  |
| <p>4. The Chairman of the audit committee shall be an</p>   | <p>4. The members of the audit committee shall elect a</p>  |

**Guidance Note on Certification of Corporate Governance**

|  |   |
|--|---|
| <p>“independent” director and shall be present at Annual General Meeting to answer queries of the shareholders.</p>  | <p>chairman from amongst themselves. The Chairman of the Audit Committee shall attend the annual general meetings of the company to provide any clarification on matters relating to audit.</p>   |
| <p>5. A representative of the external auditor, when required shall be present as an invitee for the meetings of the audit committee. The audit committee may invite such of the executives to be present at the meetings of the committee. The Finance Director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee.</p> | <p>5. The Auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the audit committee but shall not have the right to vote.</p> |
| <p>6. The Company Secretary shall act as Secretary to the audit committee.</p>   | <p>6. No such reference is contained in the Companies Act, 1956.</p>  |

The following additional requirements are stipulated as per Clause 49 of the Listing Agreement on which Section 292A (relating to audit committee) is silent:

- (i) The audit committee may invite such of the executives, as it considers appropriate (and particularly head of the finance function) to be present at the meeting of the committee, but on occasions, it may also meet without the presence of any executives of the company.
- (ii) The company secretary shall act as secretary to the committee.
- (iii) The audit committee shall meet at least four times in a year. The gap between two meetings should not be more than four months.

- (iv) The quorum of the audit committee shall be two members or one-third of the members of the audit committee whichever is higher and minimum of two independent directors be present.
- (v) The powers and role of the audit committee are elaborately contained in Clause 49 II (C) & (D).
- (vi) All members of the audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

The following additional requirements are stipulated as per Section 292A the Companies Act, 1956 (relating to audit committee) on which Clause 49 of the Listing Agreement is silent:

- (i) The audit committee constituted shall act in accordance with terms of reference to be specified in writing by the Board.
- (ii) The recommendations of the audit committee on any matter relating to financial management, including the audit report, shall be binding on the Board.
- (iii) If the Board does not accept the recommendations of the audit committee, it shall record the reasons therefor and communicate such reasons to the shareholders.

**9.4** The auditor should ascertain from the minutes book of the Board meetings whether a qualified and independent audit committee has been set up, which comprises a minimum of three members. The auditor should ascertain whether two-thirds of the members of the audit committee are independent directors and whether all members of audit committee are financially literate and at least one member has accounting or related financial management expertise. The term "financially literate"<sup>27</sup> means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

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<sup>27</sup> As given in Explanation 1 to Clause 49 II (A) dealing with Qualified and Independent Audit Committee – See Page 19.

## ***Guidance Note on Certification of Corporate Governance***

**9.5** The auditor should ascertain from the minute book of the audit committee whether the audit committee has met at least four times in a year and not more than four months have elapsed between two meetings.

**9.6** The auditor should ascertain from the minute book of the audit committee whether the quorum i.e. two members or one-third of the members of the audit committee, whichever is higher with a minimum of two independent directors were present in every meeting of the audit committee.

**9.7** The auditor should ascertain whether the Chairman of the Audit Committee is an independent director. The expression “independent director” has been discussed in Clause 49 (I) (A) (iii) vide paragraph 8.2<sup>28</sup>.

**9.8** The auditor should ascertain from the annual general meeting (herein after referred to as AGM) attendance book and minutes book whether the chairman of the audit committee was present in the meeting to answer shareholders’ queries. In case the Chairman has not been present at the AGM, auditor should ensure that this be suitably disclosed. The AGM of the financial year which is under audit would be held subsequent to the auditor submitting the certificate of compliance of conditions of corporate governance and hence, the requirement would be to verify this condition with reference to the last AGM held.

**9.9** The auditor should ascertain if the practice of inviting the executives (particularly the head of the finance function) in the audit committee meetings is being followed; he should further ascertain from the minutes book of the audit committee whether the executives did attend the meetings. His presence at such audit committee meetings (pursuant to Section 292A of the Companies Act, 1956) is only by invitation, with due notice to attend.

**9.10** The auditor should ascertain from the minutes book of the audit committee whether the finance director, the head of internal audit and representative of the statutory auditor were present as invitees in the meetings of the audit committee.

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<sup>28</sup> See at Page Nos. 9 - 10.

### **9.11 II(C) Powers of Audit Committee**

*The audit committee shall have powers, which should include the following:*

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

### **[Clause 49 II (C)]**

**9.12** The auditor should check whether the terms of reference of the audit committee have been suitably framed mentioning the above powers. It is mandatory that the above-mentioned four powers to be vested in the Audit Committee. The Board may delegate / vest further powers to the committee. Further it may also be noted that the four powers as mentioned above are only illustrative and not exhaustive.

### **9.13 II (D) Role of Audit Committee**

*The role of the audit committee shall include the following:*

- 1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.*
- 2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.*
- 3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.*
- 4. Reviewing, with the management, the annual financial statements before submission to the board for approval, with particular reference to:*

## **Guidance Note on Certification of Corporate Governance**

- (a) Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause 2AA of section 217 of the Companies Act, 1956*
  - (b) Changes, if any, in accounting policies and practices and reasons for the same*
  - (c) Major accounting entries involving estimates based on the exercise of judgment by management*
  - (d) Significant adjustments made in the financial statements arising out of audit findings*
  - (e) Compliance with listing and other legal requirements relating to financial statements*
  - (f) Disclosure of any related party transactions*
  - (g) Qualifications in the draft audit report.*
- 5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval*
- 5A<sup>29</sup> Reviewing, with the management the statement of uses/application of funds raised through an issue (public issue, rights issue, preferential issue, etc), the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter.*
- 6. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.*
- 7. Reviewing the adequacy of internal audit function, if any including the structure of the internal audit department, staffing and seniority of the official heading the*

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29 Inserted by SEBI/CFD/DIL/LA/4/2007/7/12 dated 27-12-2007



*department, reporting structure coverage and frequency of internal audit.*

8. *Discussion with internal auditors any significant findings and follow up there on.*
9. *Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.*
10. *Discussion with statutory auditors before the audit commences about nature and scope of audit as well as post-audit discussion to ascertain any area of concern.*
11. *To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.*
12. *To review the functioning of the Whistle Blower mechanism, in case the same is existing.*
13. *Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.*

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

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

**[Clause 49 II (D)]**

**9.14** The sub-sections 6 & 7 of Section 292A are reproduced below. These specify the functions of the Audit Committee:

**“S.292A – Audit Committee**

## **Guidance Note on Certification of Corporate Governance**

- (6) *The Audit Committee should have discussions with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half-yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems.*
- (7) *The Audit Committee shall have authority to investigate into any matter in relation to the items specified in this section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice, if necessary”.*

**9.15**The auditor should ascertain from the minutes of the Board meeting whether the terms of reference of the audit committee inter alia include the powers, that are mentioned in Clause 49 II (C) and also matters that are mentioned in Clause 49 II (D) in order to enable the audit committee to effectively carry out the role assigned to it.

### **9.16II (E) Review of information by Audit Committee**

*The Audit Committee shall mandatorily review the following information:*

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

**[Clause 49 II (E)]**

**9.17**The auditor should ascertain from the minutes book of the audit committee and other sources like agenda papers, etc. whether the audit Committee has reviewed the above-mentioned information. The auditor should ascertain whether as a part of directors' report or as an addition thereto, management discussion and analysis report form part of the annual report to the shareholders. Under the old Clause 49, this was specifically mandated, but not spelt out clearly now. The auditor should further ascertain whether the management discussion and analysis includes discussion on the matters stipulated in this sub-clause.

**9.18**Where certain deficiencies or adverse findings are noted by the audit committee, the auditor will see that these have been suitably dealt with by the management in the Report on Corporate Governance.

**9.19**The auditor should ascertain that the information reviewed by the Audit Committee is consistent with reporting in the financial statements, including those drawn up giving segment wise break-up for compliance of AS 17 (Segment Reporting)

### **9.20III. Subsidiary Companies**

- (i) At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of a material non listed Indian subsidiary company.*
- (ii) The Audit Committee of the listed holding company shall also review the financial statements, in particular, the investments made by the unlisted subsidiary company.*
- (iii) The minutes of the Board meetings of the unlisted subsidiary company shall be placed at the Board meeting of the listed holding company. The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.*

**Explanation 1:** *The term "material non-listed Indian subsidiary" shall mean an unlisted subsidiary, incorporated in*

## **Guidance Note on Certification of Corporate Governance**

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

**Explanation 2:** *The term “significant transaction or arrangement” shall mean any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the material unlisted subsidiary for the immediately preceding accounting year.*

**Explanation 3:** *Where a listed holding company has a listed subsidiary which is itself a holding company, the above provisions shall apply to the listed subsidiary insofar as its subsidiaries are concerned.*

### **[Clause 49 (III)]**

**9.21** Clause 49 III (i) requires the appointment of at least one independent director of a holding company to be appointed as a director of a material non-listed Indian subsidiary company. The concept of “material” non-listed subsidiary is explained in Explanation 1, under the clause.

**9.22** In regard to taking note of the proceedings of the Board of the unlisted company, Clause 49 III (iii) requires the minutes of the Board of every unlisted subsidiary to be placed before the Board of the holding company. The management of the holding company has also to periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all the significant transactions and arrangements entered into by the unlisted subsidiary company. This applies only in regard to “significant transaction or arrangement” the meaning of which is given in Explanation 2 under the clause.

**9.23** Reading the Explanation 2 in totality, it would seem that the disclosure to the Board of the holding company would apply only where such significant transaction or arrangement are entered into by a company which is a material unlisted subsidiary as mentioned above.

**9.24** It may further be noted that the plain reading of Explanation 2 would indicate that the least of total revenues, total expenses, total assets or total liabilities of the immediately preceding accounting year are to be considered as the basis for computing benchmark of 10% thereof. However, the use of the words 'or' coupled with 'as the case may be' would support the more logical view that one has to apply the test by comparing like items. For example, a capital expenditure has to be compared with aggregate capital expenditure for the year. When comparing any transaction with 'total revenues', "total expenses", etc., one may take into consideration the total revenue or expenditure 'likely to' arise for the entire preceding financial year and not necessarily the aggregate expenditure incurred.

**9.25** Clause 49 III (ii) requires the audit committee of the listed holding company to review the financial statements and in particular, the investments made by the unlisted subsidiary company would apply to all the unlisted subsidiary companies. This is required in regard to all unlisted subsidiaries, without reference to materiality or place of incorporation etc. Where however the subsidiary of a listed company is itself a listed company, the Explanation 3 would apply.

#### **9.26 IV. Disclosures**

##### **IV (A) Basis of related party transactions**

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

**[Clause 49 IV (A)]**

## **Guidance Note on Certification of Corporate Governance**

**9.27.** The Report on Corporate Governance requires disclosure of certain transactions with related parties or transactions, which may not be 'arms length' transactions. The auditor is required to verify whether the management has placed the information before the Audit Committee periodically.

**9.28** The transactions to be disclosed by the management are:

- (a) Transactions with related parties; entered into in the ordinary course of business are to be disclosed in summary form (Grouping them into broad categories of the transactions).
- (b) Transactions with related parties which do not fall within the normal business transactions (and are therefore not covered in (a) above) are to be disclosed individually if such transactions are material transactions.
- (c) Transactions with any party (related or otherwise) which are not considered as arm's length transactions are to be disclosed individually, if such transactions are material transactions.

**9.29** The auditor has to verify whether a transaction is a related party transaction as per AS 18 (Related Party Disclosures). As per AS 18, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and / or operating decisions. For the purpose of verification, reference may be made to AAS 23 (Related Parties).

**9.30** Materiality depends on the size and nature of the item judged in the particular circumstances.

### **9.31V (B) Disclosure of Accounting Treatment**

*Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more*

*representative of the true and fair view of the underlying business transaction in the Corporate Governance Report.*

***[Clause 49 IV (B)]***

**9.32**In this regard the auditor has to refer to Sections 211(3B), 217(2AA) and 227 of the Companies Act, 1956. The auditor has also to refer to the CEO / CFO certification given under Clause 49 V.

**9.33IV (C) Board Disclosures – Risk management**

*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 management controls risk through means of a properly defined framework.*

***[Clause 49 IV (C)]***

**9.34**The auditor should ascertain whether the executive management has a properly defined framework for risk management and its control. This would involve defining such framework on the lines illustrated in Appendix – B<sup>30</sup>. For a broad reference for assessment of risk etc., and techniques of assessment, he has to further ascertain that such framework in terms of procedure has been informed to the Board members. The evaluation of internal control and risk management is a part of the audit process mentioned in the auditing standards.

**9.35**The risk management framework provides an integrated approach for identifying, assessing, prioritizing, mitigating, monitoring and reporting business risks across the organization. The company is required to develop a framework on the basis of which executive management is required to assess risks and minimize the impact of risk. Further, these risk management procedures are required to be reviewed periodically by the management.

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<sup>30</sup> See Appendix B at Page No 50

## **Guidance Note on Certification of Corporate Governance**

**9.36**The existence of a risk management framework may be evidenced by the parameters given in Appendix B<sup>31</sup>. Some of these are tangible and can be evidenced by appropriate documentation. Whereas intangibles are concerned, the existence of it needs to be ascertained through enquiries and interviews. Further the auditor should also ensure that the management has effectively implemented the risk management framework and that it is applied to activities and processes of the business and communicated throughout the organization.

### **9.37IV (D) Proceeds from Public Issues, Rights Issues, Preferential Issues etc.**

*When money is raised through an issue (public issues, rights issues, preferential issues etc.), it shall disclose to the Audit Committee, the use / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and place it before the audit committee. Such disclosure shall be made only till such time that the full money raised through the issue has been fully spent. This statement shall be certified by the statutory auditors of the company. Furthermore, where the company has appointed a monitoring agency to monitor the utilization of proceeds of a public or rights issue, it shall place before the Audit Committee the monitoring report of such agency, upon receipt, without any delay.<sup>32</sup> The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.*

### **[Clause 49 IV (D)]**

**9.38**The object of this sub-clause is to ensure that all cases of diversion of funds from the proceeds of issues<sup>33</sup>, should be appropriately brought to the notice of the audit committee for

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<sup>31</sup> See Appendix-B at Page No. 50

<sup>32</sup> SEBI/CFD/DIL/LA/4/2007/27/12, Circular dt 27<sup>th</sup> December, 2007

<sup>33</sup> Issues would include public issues of depository receipts, Foreign Currency Convertible Bonds (FCCB) referred to by various SEBI Regulations.



taking suitable action. Also, it is desirable that quarterly and yearly report on this is placed before the audit committee for its review and action if any. It is to be noted that the disclosure under the sub-clause should continue to be made till the time the issue money is utilized in full and the statutory auditors gave a certificate to this effect. Further it may be noted that statement shall pertain only to the year in which the money has been raised or till such time the money is fully spent whichever is later.

**9.39** The following procedure may be noted for carrying out the aforesaid action on the uses and applications of the funds from proceeds from public issues etc:

- ❑ The quarterly report on the uses / application of funds shall be placed before the Audit Committee by the management.
- ❑ In case the company has appointed a monitoring agency for monitoring the proceeds of public or rights issue, to make sure that the report of such monitoring agency was placed before the Audit Committee<sup>34</sup>.
- ❑ Diversion of funds, if any, shall be brought to the attention of the Audit Committee by the management
- ❑ The management would then obtain a duly certified statement from the statutory auditors of the company and places it before the Audit Committee to enable the discontinuance of reporting thereafter.

#### **9.40IV (E) Remuneration of Directors**

- (i) *All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company shall be disclosed in the Annual Report.*
- (ii) *Further the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report:*

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34 SEBI/CFD/DIL/LA/4/2007/27/12 December 27, 2007

## **Guidance Note on Certification of Corporate Governance**

- (a) *All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc.*
  - (b) *Details of fixed component and performance linked incentives, along with the performance criteria.*
  - (c) *Service contracts, notice period, severance fees.*
  - (d) *Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.*
- (iii) *The company shall publish its criteria of making payments to non-executive directors in its annual report. Alternatively, this may be put up on the company's website and reference drawn thereto in the annual report.*
- (iv) *The company shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report.*
- (v) *Non-executive directors shall be required to disclose their shareholding (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 be disclosed in the notice to the general meeting called for appointment of such director.*

### **[Clause 49 IV (E)]**

**9.41** All pecuniary relationship or transactions of the non-executive director vis-à-vis the company is required to be disclosed in the annual report. The auditor should check whether the particulars regarding remuneration package of individual directors summarized under major groups have been disclosed in the section in the Corporate Governance of the annual report.

**9.42** Sub-Clause (iii) requires the publication of the criteria of making payments to the non-executive directors. This implies that the Board or the Remuneration Committee will have to frame a

specific policy for such remuneration. Such policy or criteria will have to be published in its annual report. Alternatively, if the same is put up on the company's website, a reference to this disclosure will have to be made in the annual report.

**9.43** Companies are required to disclose annually the details relating to shareholding by the non-executive directors. However, non-executive directors shall be required to make such disclosure on one time basis prior to his joining the Board. Further, the notice of general meeting proposing to appoint such a Director is required to disclose details of shareholding of the directors in the company. For this purpose, the Director shall make suitable disclosures to the company prior to his appointment and annually.

**9.44IV (F) Management**

- (i) As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company's competitive position:*
  - (i) Industry structure and developments*
  - (ii) Opportunities and Threats*
  - (iii) Segment-wise or product-wise performance*
  - (iv) Outlook*
  - (v) Risks and concerns*
  - (vi) Internal control systems and their adequacy*
  - (vii) Discussion on financial performance with respect to operational performance*
  - (viii) Material developments in Human Resources / Industrial Relations front, including number of people employed.*

## **Guidance Note on Certification of Corporate Governance**

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

**Explanation:** *For this purpose, the term "senior management" shall mean personnel of the company who are members of its core management team excluding the Board of Directors). This would also include all members of management one level below the executive directors including all functional heads.*

### **[Clause 49 IV (F)]**

**9.45**The above information presented by the Management is likely to include non-financial information, which may be outside the area of auditors' expertise. In such a situation, the auditor may keep in mind the AAS 20 relating to Knowledge of the business and the fact that he is only required to review the compliance with disclosure requirements and not verify the particular facts as disclosed by the management.

**9.46**The auditor should ascertain that this information [i.e. segment-wise or product-wise performance (sub-clause (iii) as stated above) and considered as a part of Management Discussion and Analysis Report ] is consistent with what is reported in financial statements complying with AS 17 (Segment Reporting) and also as per the provisions of Sections 211, 217(2AA) and 227 of the Companies Act, 1956.

### **9.47IV (G) Shareholders**

- (i) *In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information:*
  - (a) *A brief resume of the director;*
  - (b) *Nature of his expertise in specific functional areas;*

- (c) *Names of companies in which the person also holds the directorship and the membership of Committees of the Board; and*
- (d) *Shareholding of non-executive directors as stated in Clause 49 (IV) (E) (v) above*
- (i) *Disclosure of relationships between directors inter-se shall be made in the Annual Report, notice of appointment of a director, prospectus and letter of offer for issuances and any related filings made to the stock exchanges where the company is listed.<sup>35</sup>*
- (ii) *Quarterly results and presentations made by the company to analysts shall be put on company's web-site, or shall be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own web-site.*
- (iii) *A board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders / Investors Grievance Committee'.*
- (iv) *To expedite the process of share transfers, the Board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.*

**[Clause 49 IV (G)]**

**9.48**The auditor shall ascertain from the communications sent, whether in the case of appointment of a new director or re-appointment of a director the shareholders were provided with the

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<sup>35</sup> SEBI Circular NO. SEBI/CFD/DIL/CG/1/2008/08/04 dated April 8, 2008

## ***Guidance Note on Certification of Corporate Governance***

information stipulated in sub-clause (i) and (ia)<sup>36</sup> as mentioned above.

**9.49**The auditor should see that the references contained in the above paragraph have been complied therewith.

**9.50**The Auditor should ascertain from the company's website whether information like quarterly results and presentation made by the entity to analyst which have been put on company's website or whether such information has been sent in a form to the Stock Exchange in which the company's securities are listed to enable it to put it on its own website. The auditor should also ascertain whether the other information which are mandatorily required to be disclosed to the shareholders as per the Listing Agreement or as per the Companies Act, 1956 are put on company's website or alternatively sent to the stock exchange on which the company's securities are listed to enable it to put it on its own website.

**9.51**The auditor should ascertain from the minute book of the Board meeting whether a Board committee, Shareholders/Investors Grievance Committee has been set up under the chairmanship of a non-executive director to specifically look into redressing of shareholder and investors complaints such as transfer of shares, non receipt of balance sheet, non receipt of declared dividends, etc. Further the auditor should also ascertain from the minute book of the Shareholders/Investors Grievance Committee whether such committee is prima-facie functioning.

**9.52**The auditor should also verify from the records of the Shareholders / Investors Grievance Committee as well as from the certificate obtained by the company from SEBI and Stock Exchange(s), if any, about the investors grievances pending upto the date of certificate of compliance of conditions of corporate governance.

**9.53**The auditor should ascertain from the minute book of the Board meeting whether the company has delegated the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The auditor should also verify from the

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<sup>36</sup> SEBI Circular NO. SEBI/CFD/DIL/CG/1/2008/08/04 dated April 8, 2008

records maintained to ascertain whether the delegated authority has attended to share transfer formalities at least once in a fortnight. The auditor may verify whether any transfer requests have remained pending for more than a fortnight and not attended to.

#### **9.54V. CEO / CFO Certification**

*The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that:*

- (a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :
  - (i) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;*
  - (ii) these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.**
- (b) There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.*
- (c) They accept responsibility for establishing and maintaining internal controls for financial reporting<sup>37</sup> and that they have evaluated the effectiveness of the internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.*

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<sup>37</sup> Inserted by SEBI Circular dt 13<sup>th</sup> January, 2006 – See Appendix F at Page Nos 57 - 59

## **Guidance Note on Certification of Corporate Governance**

- (d) *They have indicated to the auditors and the Audit committee:*
- (i) *significant changes in internal control over financial reporting<sup>38</sup> during the year;*
  - (ii) *significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and*
  - (iii) *instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting<sup>39</sup>.*

### **[Clause 49 V]**

**9.55** The amendments effected in Clause 49V(c) & (d) clearly bring out that

- (a) the responsibility entrusted to the CEO / CFO is for establishing and maintaining internal controls for financial reporting.
- (b) The CEO / CFO certificate has to state that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting.
- (c) The CEO / CFO certificate will further state the manner in which deficiencies (if any) in the design or operation of such internal controls have been disclosed to the auditors and the audit committee.
- (d) The CEO / CFO certification will also state the steps they have taken or propose to take to rectify these deficiencies in the design or operation of such internal controls pertaining to financial reporting.

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<sup>38</sup> Inserted by SEBI Circular dt 13<sup>th</sup> January, 2006 – See Appendix F at Page Nos 57 - 59

<sup>39</sup> Inserted by SEBI Circular dt 13<sup>th</sup> January, 2006 – See Appendix F at Page Nos. 57 - 59



**9.56** In the context of internal controls, the auditor should ensure that

- (a) the management has institutionalized an internal control framework with respect to financial reporting controls. The framework should be examined in the context of the documentation created for each significant process in terms of the related risk and mitigating control;
- (b) he has further examined whether the assessment process followed for evaluation of controls is reasonable and that there is a process by which significant deficiencies as well as steps taken to correct them are communicated to the audit committee and to the auditors; and
- (c) he should also examine whether there is a process in the company whereby all significant changes in the accounting policies and the system of internal controls are communicated to the audit committee and the auditors.

**9.57** The auditor should examine the adequacy of the process followed for issuing the CEO / CFO certificate and should review the same in regard to matters stated in Para 9.52 above and the consideration of the same by the audit committee. For this purpose he should refer to the minutes of the audit committee.

**9.58** In situations where negative or adverse comment or exclusions / disclaimer are contained in the CEO / CFO certificate, the auditor should take cognizance of the same as the circumstances require in the audit report and or the Certificate of Compliance of conditions of Corporate Governance.

**9.59 VI. Report on Corporate Governance**

- (i) *There shall be a separate section on Corporate Governance in the Annual Reports of company, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirement of this clause with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted. The suggested list of items to*

## **Guidance Note on Certification of Corporate Governance**

*be included in this report is given in Annexure – I C and list of non-mandatory requirements is given in Annexure – I D.*

- (ii) *The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format given in Annexure - I B. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company.*

### **[Clause 49(VI)]**

**9.60** The auditor should ascertain whether the Board of directors have included in the annual report of the company a separate section on corporate governance, with a detailed compliance report on corporate governance. This would specifically highlight non-compliance of any mandatory requirement. (i.e., which is part of the Listing Agreement) with reasons thereof and also the extent to which the non-mandatory requirements have been adopted. The auditor should also verify whether the suggested list of items to be included in this report as per Annexure - I C<sup>40</sup> of Clause 49 and list of non-mandatory requirements as per Annexure - I D<sup>41</sup> of Clause 49 have been incorporated in such report. *(Latest Circulars on Revised Clause 49<sup>42</sup> along with its Annexures are reproduced at the end of this guidance note.)*

**9.61** Any data in the report on corporate governance should not be inconsistent with what is contained in the financial statements.

## **10. Management Representations**

The auditor should consider obtaining management representations on conditions of Corporate Governance in accordance with AAS 11, "Management Representations".

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<sup>40</sup> Page Nos 100 - 103

<sup>41</sup> Page Nos 104 - 105

<sup>42</sup> See Page Nos 78 - 94

## 11. Auditors' Certificate

### 11.1VII. Compliance

- (1) *The company shall obtain a certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.*
- (2) *The non-mandatory requirements given in Annexure – I D may be implemented as per the discretion of the company. However, the disclosures of the compliance with mandatory requirements and adoption (and compliance) / non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report.*

**[Clause 49(VII)]**

11.2A draft of the Auditors' Certificate on compliance of conditions of Corporate Governance is given in *Appendix – C*.<sup>43</sup> Depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of Corporate Governance e.g.,

- (a) The number of non-executive directors is less than 50% of the strength of Board of directors.
- (b) A qualified and independent audit committee is not set up.
- (c) The chairman of the audit committee is not an independent director.

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<sup>43</sup> Appendix – C at Page Nos.51 - 52

### ***Guidance Note on Certification of Corporate Governance***

- (d) The audit committee has not meet four times a year.
- (e) The necessary powers in terms of Clause 49 II (D) of the Listing Agreement have not been vested by the Board in the audit committee.
- (f) The time gap between two Board meetings is more than four months.
- (g) A director is a member of more than ten committees across all companies in which he is a director.
- (h) The information of quarterly results is neither put on the company's website nor sent in a form so as to enable the Stock Exchange on which the entity's securities are listed to enable such Stock Exchange to put it on its own website.
- (i) The power of share transfer is not delegated to an officer or a committee or to the registrar and share transfer agents.

## **12. Role of the Auditor in Audit Committee & Certification of Compliance of Conditions of Corporate Governance**

**12.1**The amendment to Listing Agreement and the Companies Act, 1956 in respect of the constitution of audit committee underline the importance of the audit process and its contribution to the corporate governance process. Clause 49 stipulates that a representative of the statutory auditor, when required, shall be present as an invitee for the meetings of the audit committee. Section 292A of the Companies Act, 1956 stipulates that the auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate in meetings of the audit committee but shall have no right to vote.

**12.2**The auditor would be informing the audit committee on various matters connected with the audit from time to time. He can contribute significantly in assisting and advising the audit committee as per the request of the audit committee, particularly in

improving corporate governance, oversight of financial reporting process, implementation of accounting policies and practices, compliance with accounting standards and strengthening of the internal control systems in regard to financial reporting and reporting processes.

**12.3**The auditor would devote substantial part of his professional time to assist the management and the audit committee to enable it to discharge its functions effectively and in certification of requirements of corporate governance.

**12.4**The auditor has to bear in mind that his role is not to drive corporate governance directly, by ensuring compliance of the requirements of corporate governance. It is the responsibility of the management to ensure the same and in the process he would play a significant role in assisting the management for ensuring better standards of corporate governance.

## **APPENDIX – A**

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| <b>Sr. No.</b> | <b>Reference No.</b>         | <b>Date</b>        |
|----------------|------------------------------|--------------------|
| 1.             | SMDRP/POLICY/CIR-10/2000     | February 21, 2000  |
| 2.             | SMDRP/POLICY/CIR-13/2000     | March 09, 2000     |
| 3.             | SMDRP/POLICY/CIR-42/2000     | September 12, 2000 |
| 4.             | SMDRP/POLICY/ CIR- 03/01     | January 22, 2001   |
| 5.             | SMDRP/POLICY/ CIR- 19/01     | March 16, 2001     |
| 6.             | SMDRP/POLICY/ CIR- 53/01     | December 31, 2001  |
| 7.             | SEBI/MRD/SE/31/2003/26/08    | August 26, 2003    |
| 8.             | SEBI/CFD/DIL/CG/1/2004/12/10 | October, 29, 2004  |
| 9.             | SEBI/CFD/DIL/CG/1/2005/29/3  | March 29, 2005     |
| 10.            | SEBI/CFD/DIL/CG/1/2006/13/1  | January 13, 2006   |
| 11.            | SEBI/CFD/DIL/LA/4/2007/27/12 | December, 27, 2007 |
| 12.            | SEBI/CFD/DIL/CG/1/2008/08/04 | April, 08, 2008    |
| 13.            | SEBI/CFD/DIL/CG/2/2008/23/10 | October 23, 2008   |

# APPENDIX - B

## DISCLOSURE ABOUT RISK MANAGEMENT

| Sources of Risk       | Components of Risk                          |
|-----------------------|---|
| 1. Business Risk      | 1. Diversifiable Risk (Unsystematic Risk)   |
| 2. Financial Risk     | 2. Non-diversifiable Risk (Systematic Risk) |
| 3. Interest Rate Risk |   |
| 4. Liquidity Risk     |   |
| 5. Market Risk        |   |
| 6. Event Risk         |   |

## RISK MANAGEMENT FRAMEWORK

| Structure  | Infrastructure                             | Processes   | Awareness  |
|--|--|---|--|
| 1. Reporting Lines<br>2. Role and Responsibilities | 1. Methodologies<br>2. Systems<br>3. Tools | 1. Risk Identification<br>2. Risk Measurement<br>3. Risk Prioritization<br>4. Risk Monitoring<br>5. Risk Escalation | 1. Risk Policies<br>2. Risk Strategy<br>3. Risk Appetite of the Organization |

## APPENDIX - C

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### CERTIFICATE

To the Members of

(Name of the Company)

We have examined the compliance of conditions of corporate governance by (name of the company), for the year ended on \_\_\_\_\_, as stipulated in Clause 49 of the Listing Agreement of the said company\* with stock exchange(s).

The compliance of conditions of corporate governance is the responsibility of the management. Our examination was limited to procedures and implementation thereof, adopted by the company\* for ensuring the compliance of the conditions of the Corporate Governance. It is neither an audit nor an expression of opinion on the financial statements of the company\*.

In our opinion and to the best of our information and according to the explanations given to us, [subject to the following:

1.

2. ]

\*\*

We certify that the company\* has complied with the conditions of Corporate Governance as stipulated in the abovementioned Listing Agreement.

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\* In the event the entity is not a "company" under the Companies Act, 1956 appropriate reference may be made in place of the word "company"

\*\* Delete, if not applicable



We state that such compliance is neither an assurance as to the future viability of the company\* nor the efficiency or effectiveness with which the management has conducted the affairs of the company\* .

For and on behalf of

ABC & Co.

Chartered Accountants

( )  
Partner / Proprietor  
Membership No.  
Place:  
Date:

## APPENDIX - D

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SEBI/CFD/DIL/CG/1/2004/12/10

October 29, 2004

**The Managing Director / Executive Director / Administrator of  
all the Stock Exchanges**

Dear Sir / Madam,

**Sub: Corporate Governance in listed Companies –  
Clause 49 of the Listing Agreement**

1. All Stock Exchanges are hereby directed to amend the Listing Agreement by replacing the existing Clause 49 of the listing agreement (issued vide circulars dated 21st February, 2000, 9th March 2000, 12th September 2000, 22nd January, 2001, 16th March 2001 and 31st December 2001) with the revised Clause 49 given in Annexure I through I D to this circular. SEBI Circular no. SEBI/MRD/SE/31/2003/26/08 dated August 26, 2003 (which has been since deferred) is hereby withdrawn. The revised Clause 49 also specifies the reporting requirements for a company.
2. Please note that this is a master circular which supersedes all other earlier circulars issued by SEBI on Clause 49 of the Listing Agreement.
3. The provisions of the revised Clause 49 shall be implemented as per the schedule of implementation given below:
  - (a) For entities seeking listing for the first time, at the time of seeking in-principle approval for such listing.
  - (b) For existing listed entities which were required to comply with Clause 49 which is being revised i.e. those having a paid up share capital of Rs. 3 crores and above or net worth of Rs. 25 crores or more at any time in the history of the company, **by April 1, 2005.**

Companies complying with the provisions of the existing Clause 49 at present (issued vide circulars dated 21st February 2000, 9th March 2000, 12th September 2000, 22<sup>nd</sup> January 2001 16th March 2001 and 31st December 2001) shall continue to do so till the revised Clause 49 of the Listing Agreement is complied with or till **March 31, 2005**, whichever is earlier.

4. The companies which are required to comply with the requirements of the revised Clause 49 shall submit a quarterly compliance report to the stock exchanges as per sub Clause VI (ii), of the revised Clause 49, within 15 days from the end of every quarter. The first such report would be submitted for the quarter ending **June 30, 2005**. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company.
5. The revised Clause 49 shall apply to all the listed companies, in accordance with the schedule of implementation given above. However, for other listed entities which are not companies, but body corporate (e.g. private and public sector banks, financial institutions, insurance companies etc.) incorporated under other statutes, the revised Clause 49 will apply to the extent that it does not violate their respective statutes and guidelines or directives issued by the relevant regulatory authorities. The revised Clause 49 is not applicable to Mutual Funds.
6. The Stock Exchanges shall ensure that all provisions of the revised Clause 49 have been complied with by a company seeking listing for the first time, before granting the in-principle approval for such listing. For this purpose, it will be considered satisfactory compliance if such a company has set up its Board and constituted committees such as Audit Committee, Shareholders / Investors Grievances Committee etc. in accordance with the revised clause before seeking in-principle approval for listing.
7. The Stock Exchanges shall set up a separate monitoring cell with identified personnel to monitor the compliance with the provisions of the revised Clause 49 on corporate governance.

***Guidance Note on Certification of Corporate Governance***

The cell, after receiving the quarterly compliance reports from the companies which are required to comply with the requirements of the revised Clause 49, shall submit a consolidated compliance report to SEBI within 60 days from the end of each quarter.

**Encl: Annexure I, I A, I B, I C & I D<sup>44</sup>**

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<sup>44</sup> See at Page Nos.56 - 69

# APPENDIX - E

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SEBI/CFD/DIL/CG/1/2005/29/3

March 29, 2005

**The Managing Director / Executive Director / Administrator of  
all the Stock Exchanges**

Dear Sir / Madam,

**Sub: Corporate Governance – Clause 49 of the Listing  
Agreement**

Please refer to SEBI circular no. SEBI/CFD/DIL/CG/1/2004/12/10 dated October 29, 2004 containing the revised provisions of Clause 49 of the listing agreement.

It has been brought to our notice that a large number of companies are still not in a state of preparedness to be fully compliant with the requirements as contained in the aforesaid circular. As it is our wont that all listed companies and companies desirous of getting listed should achieve best corporate governance status, it was felt that more time should be allowed to them to conform to Clause 49 of the listing agreement as revised in terms of the aforesaid circular. Accordingly, the date for ensuring compliance with the revised Clause 49 of the listing agreement has been now extended upto December 31, 2005.

Yours faithfully,

## **APPENDIX - F**

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**SEBI/CFD/DIL/CG/1/2006/13/1**  
**January 13, 2006**

**The Managing Director / Executive Director /  
Administrator  
of all the Stock Exchanges**

Dear Sir / Madam,

**Sub: Corporate Governance in listed Companies – Clause 49  
of the Listing Agreement**

SEBI, vide circular SEBI/CFD/DIL/CG/1/2004/12/10 dated October 29, 2004, issued the revised clause 49 of the listing agreement, which was to come into effect by April 1, 2005. Since it was brought to SEBI's notice that a large number of companies were still not in a state of preparedness to be fully compliant with the requirements as contained in the revised clause 49, SEBI extended the date for ensuring compliance with the revised Clause 49 of the listing agreement upto December 31, 2005 vide circular no. SEBI/CFD/DIL/CG/1/2005/29/3 dated March 29, 2005. The revised clause 49 thus has come into effect from January 1, 2006.

SEBI has been in receipt of a number of requests / suggestions to bring about clarifications on certain provisions of the revised Clause 49. After examining the same, it has been decided to make the following changes to certain provisions of the revised clause 49:

- ❑ The maximum time gap between two Board meetings has been increased from three months to four months.
- ❑ Sitting fees paid to non-executive directors as authorized by the Companies Act, 1956 would not require the previous approval of shareholders.

- Certification of internal controls and internal control systems by CEO / CFO would be for the purpose for financial reporting.

In view of the above, certain changes have to be incorporated in the revised Clause 49, details of which are placed in Annexure I

The Stock Exchanges are advised to accordingly amend the listing agreement with immediate effect.

Yours faithfully,

### **ANNEXURE I (to Circular dt 13<sup>th</sup> January 2006)**

Clause 49 of the Listing Agreement shall be amended as follows:

1. After sub-clause (I)(B), the following proviso shall be inserted, namely:

“Provided that the requirement of obtaining prior approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 1956 for payment of sitting fees without approval of the Central Government.”

2. In sub-clause (I)(C), for the words “three months” occurring in the first sentence, the words “four months” shall be substituted;

3. Sub-clause (V)(c) shall be substituted with the following, namely:

“(c) They accept responsibility for establishing and maintaining internal controls for financial reporting and

**Guidance Note on Certification of Corporate Governance**

that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.”

4. Sub-clause (V)(d) shall be substituted with the following, namely:

“(d) They have indicated to the auditors and the Audit committee

- (i) significant changes in internal control over financial reporting during the year;
- (ii) significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
- (iii) instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company’s internal control system over financial reporting”.



## APPENDIX - G

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### **SEBI (Disclosure and Investor Protection) Guidelines, 2000**

According to the Explanation I in paragraph 6.8.3.2, for the purpose of sub-clause (k) and (l) (of Clause 6.8.3.2) the term “promoter” shall include:

- (a) The person or persons who are in overall control of the company;
- (b) The person or persons who are instrumental in the formulation of a plan or programme pursuant to which the securities are offered to the public;
- (c) The person or persons named in the prospectus as promoter(s);

Provided that a director / officer of the issuer company or person, if they are acting as such merely in the professional capacity shall not be included in the Explanation.

### **Regulation 2(1)(h) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 1997**

'promoter' means

- (a) any person who is in control of the target company;
- (b) any person named as promoter in any offer document of the target company or any shareholding pattern filed by the target company with the stock exchanges pursuant to the Listing Agreement, whichever is later;

and includes any person belonging to the promoter group as mentioned in Explanation I:

Provided that a director or officer of the target company or any other person shall not be a promoter, if he is acting as such merely in his professional capacity.

**Guidance Note on Certification of Corporate Governance**

Explanation I: For the purpose of this clause, promoter group shall include:

- (a) in case promoter is a body corporate
  - (i) a subsidiary or holding company of that body corporate;
  - (ii) any company in which the promoter holds 10% or more of the equity capital or which holds 10% or more of the equity capital of the promoter;
  - (iii) any company in which a group of individuals or companies or combinations thereof who holds 20% or more of the equity capital in that company also holds 20% or more of the equity capital of the target company; and
- (b) in case the promoter is an individual
  - (i) the spouse of that person, or any parent, brother, sister or child of that person or of his spouse;
  - (ii) any company in which 10% or more of the share capital is held by the promoter or an immediate relative of the promoter or a firm or HUF in which the promoter or any one or more of his immediate relative is a member;
  - (iii) any company in which a company specified in (i) above, holds 10% or more, of the share capital; and
  - (iv) any HUF or firm in which the aggregate share of the promoter and his immediate relatives is equal to or more than 10% of the total.

Explanation II: Financial Institutions, Scheduled Banks, Foreign Institutional Investors (FIIs) and Mutual Funds shall not be deemed to be a promoter or promoter group merely by virtue of their shareholding:

Provided that the Financial Institutions, Scheduled Banks and Foreign Institutional Investors (FIIs) shall be treated as promoters

or promoter group for the subsidiaries or companies promoted by them or mutual funds sponsored by them."

**SEBI (Employee Stock Option Scheme and  
Employee Stock Purchase Scheme) Guidelines, 1999**

According to Clause 2.1.12, "promoter" means:

- (a) The person or persons who are in over all control of the company;
- (b) The person or persons who are instrumental in the formation of the company or programme pursuant to which the shares were offered to the public;
- (c) The person or persons named in the offer document as promoter (s);

**Provided** that a director or officer of the company, if they are acting as such only in their professional capacity will not be deemed to be a promoter.

**Explanation:** Where a promoter of a company is a body corporate, the promoters of that body corporate shall also be deemed to be promoters of the company.

## **APPENDIX - H**

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### **List of relatives as per Schedule 1A to the Companies Act, 1956**

1. Father
2. Mother (including step Mother)
3. Son (including step-Son)
4. Son's wife
5. Daughter including step-daughter
6. Father's father
7. Father's mother
8. Mother's mother
9. Mother's father
10. Son's son
11. Son's son's wife
12. Son's daughter
13. Son's daughter's husband
14. Daughter's husband
15. Daughter's son
16. Daughter's son's wife
17. Daughter's daughter
18. Daughter's daughter's husband
19. Brother (including step brother)
20. Brother's wife
21. Sister including step sister
22. Sister's husband.

# APPENDIX - I

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SEBI/CFD/DIL/LA/4/2007/27/12  
December 27, 2007

**The Managing Director / Executive Director / Administrators  
of All Stock Exchanges**

Dear Sirs,

**Sub.: Amendments to Equity Listing Agreement.**

**1.0** In order to bring more transparency in the governance of a listed company with regard to utilisation of issue proceeds and to enhance availability of and accessibility to the continuing disclosures by listed companies, it has been decided to amend Equity Listing Agreement to provide for the following: 2.0 Monitoring of utilisation of Issue Proceeds:

**2.1** As per SEBI (Disclosure and Investor Protector) (DIP) Guidelines, 2000, every issuer company making a public or rights issue of more than Rs. 500 crores is required to appoint an agency to monitor the utilisation of issue proceeds. SEBI has, vide circular dated November 29, 2007 amending the SEBI (DIP) Guidelines, mandated that a monitoring agency shall henceforth be required to file its report with the issuer company instead of with SEBI.

**2.2** Presently, clause 49 of Equity Listing Agreement requires the Audit Committee of an issuer company to monitor the utilisation of issue proceeds and to make appropriate recommendations to the Board of the issuer company. It is therefore felt that even where a monitoring agency has been appointed, the report submitted by such agency may be placed before the Audit Committee of the issuer company, so as to enable the Audit Committee to make appropriate recommendations to the Board of the

## ***Guidance Note on Certification of Corporate Governance***

issuer company. Accordingly, it has been decided to amend clause 49 of Equity Listing Agreement, requiring the issuer company to place the monitoring report filed with it before its Audit Committee.

**2.3** Further, every issuer company shall be required to inform material deviations in the utilisation of issue proceeds to the stock exchange and shall also be required to simultaneously make the material deviations / adverse comments of the Audit committee / monitoring agency public through advertisement in newspapers.

### **3.0 Electronic filing through Corporate Filing and Dissemination**

**System (CFDS), viz., [www.corpfiling.co.in](http://www.corpfiling.co.in)**

**3.1** SEBI had, vide circular no. SMD/POLICY/Cir-13/02 dated June 20, 2002, introduced a clause in Equity Listing Agreement, which inter-alia mandated electronic filing of certain corporate information through the Electronic Data Information Filing and Retrieval (EDIFAR) system hosted by the National Informatics Centre on behalf of SEBI. It has been decided to phase out EDIFAR gradually in view of a new portal, viz., CFDS put in place jointly by BSE and NSE at the URL [www.corpfiling.co.in](http://www.corpfiling.co.in). CFDS offers a XBRL enabled common platform for listed companies to file their returns with stock exchanges and also a common place for investors to view information related to listed companies.

**3.2** Accordingly, it has been decided to introduce a new clause viz., Clause 52 in Equity Listing Agreement, requiring listed companies to file information with the stock exchange only through CFDS. Over period, other modes of sending public information to stock Exchanges for compliance with clauses of Equity Listing Agreement shall be dispensed with. The companies, which are mandated to file information through CFDS or have been registered on CFDS on their own volition though not so mandated, need not file information through the EDIFAR system. The companies

which have commenced filing through CFDS shall continue to do so through CFDS only.

**3.3** BSE and NSE (Participating Stock Exchanges), which jointly own and maintain CFDS, shall, in a phased manner, ensure that CFDS is made available to all listed companies for their corporate filings, irrespective of the stock exchange on which the companies are listed. Participating Stock Exchanges shall shortlist companies, based on market capitalization and disseminate and publish the said list from time to time and make it available on the website of the Exchanges as well as on CFDS at the URL [www.corpfiling.co.in](http://www.corpfiling.co.in).

**4.0** Accordingly, new clauses 43A and 52 shall be inserted in Equity Listing Agreement and existing clauses 49 and 51 of Equity Listing Agreement shall be amended as detailed in the Annexure I

**5.0** All stock exchanges are advised to:

**5.1** Give effect to the above mentioned policy amendments and appropriately amend the relevant clauses of Equity Listing Agreement in line with the text of the amendments specified in Annexure I.

**5.2** Make consequential changes in other clauses of Equity Listing Agreement.

**5.3** Communicate to SEBI the status of implementation of the requirements of this circular in the next Monthly Development Report.

**6.0** Applicability:

All Stock Exchanges shall ensure that:

**6.1** Clause 52 shall be applicable to all those companies whose names shall be specified by the Participating Stock Exchanges from time to time. The first 100 companies identified by the Participating Stock Exchanges, a list of

***Guidance Note on Certification of Corporate Governance***

which is available on the websites of the Participating Stock Exchanges, shall make all their submissions through CFDS from the period starting from January 1, 2008. Initially, these companies shall be required to make their submissions to the respective stock exchanges through CFDS, in addition to the modes provided in Equity Listing Agreement, i.e., through fax/courier, etc.

**6.2** Users are requested to give their feedback on the CFDS at [cfdsfeedback@nse.co.in](mailto:cfdsfeedback@nse.co.in) and [corp.relations@bseindia.com](mailto:corp.relations@bseindia.com) so as to improve the efficiency and effectiveness of the portal.

**6.3** All other amendments to Equity Listing Agreement shall come into force with effect from the date of amendment.

**7.0** This circular is issued in exercise of powers conferred by subsection (1) of Section 11, read with sub-section (2) of Section 11A, of the Securities and Exchange Board of India Act, 1992, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

**8.0** This circular is available on SEBI website at [www.sebi.gov.in](http://www.sebi.gov.in) under the categories “Legal Framework” and “Issues and Listing”.

Yours faithfully



## **Annexure I ( to Circular December 27, 2007)**

1. After clause 43, the following clause shall be inserted, namely:-

“43A. Statement of deviations in use of issue proceeds (1) The company agrees to furnish to the stock exchange on a quarterly basis, a statement indicating material deviations, if any, in the use of proceeds of a public or rights issue from the objects stated in the offer document. (2) Where the company has appointed a monitoring agency to monitor utilisation of proceeds of a public or rights issue and such monitoring agency has pointed out any deviation in the use of the proceeds of the issue from the objects stated in the offer document or has given any other reservations about the end use of funds, the company agrees to intimate the same to the stock exchange, without any delay. (3) The information mentioned in sub-clause (1) shall be furnished to the stock exchange along with the interim or annual financial results submitted under clause 41 and shall be published in the newspapers simultaneously with the interim or annual financial results, after placing it before the Audit Committee in terms of clause 49. (4) The information mentioned in sub-clause (2) shall, after review by the Audit Committee, be furnished to the stock exchange as and when received and shall simultaneously be published in the newspapers.”

2. In clause 49 –

(a) in sub-clause (II)(D), after item (5), the following new item shall be inserted, namely:-

“5A. Reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate

***Guidance Note on Certification of Corporate Governance***

recommendations to the Board to take up steps in this matter.” (b) in sub-clause (IV)(D), after the words “statutory auditors of the company” and before the words “The audit committee shall make appropriate recommendations”, the following shall be inserted, namely:-

“Furthermore, where the company has appointed a monitoring agency to monitor the utilisation of proceeds of a public or rights issue, it shall place before the Audit Committee the monitoring report of such agency, upon receipt, without any delay.”

3. In clause 51, after sub-clause (3), the following sub-clause shall be inserted, namely:-

“(4) Notwithstanding anything in sub-clauses (1), (2) and (3), the company need not file on the EDIFAR website, any information, statement or report which has already been filed on the Corporate Filing and Dissemination System in pursuance of clause 52.”

4. After clause 51, the following clause shall be inserted, namely:-

“52. Corporate Filing and Dissemination System (CFDS), viz., [www.corpfiling.co.in](http://www.corpfiling.co.in) (1) The company agrees - (a) to file on the CDFS, such information, statements and reports as may be specified by the Participating Stock Exchanges in this regard. (b) that the Compliance Officer, appointed under clause 47(a) and the company shall be responsible for ensuring the correctness, authenticity and comprehensiveness of the information, statements and reports filed under this clause and also for ensuring that such information is in conformity with the applicable laws and the listing agreement.” (c) to ensure that the electronic filing of information through CFDS, pursuant to compliance with any clause of the listing agreement, shall be done within the time limit specified in the respective clause of the listing agreement. (d) to put in place such infrastructure as may be required to comply with the clause.

Explanation: For the purposes of this clause –

(i) The term “Corporate Filing and Dissemination System (CFDS)” shall mean the portal at the URL [www.corpfiling.co.in](http://www.corpfiling.co.in) or such other website as may be specified by the participating stock exchanges from time to time to take care of exigencies, if any.

(ii) The term “Participating Stock Exchanges” shall mean the stock exchanges owning and maintaining CFDS.”

## **APPENDIX - J**

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**SEBI/CFD/DIL/CG/1/2008/08/04**  
**April 08, 2008**

**The Managing Director/Executive Director/Administrator  
of all the Stock Exchanges**

Dear Sir/Madam,

**Sub: Corporate Governance in listed Companies – Clause  
49 of the Listing Agreement**

I. SEBI, vide circular SEBI/CFD/DIL/CG/1/2004/12/10 dated October 29, 2004, issued the revised clause 49 of the listing agreement, which has come into effect from January 1, 2006.

SEBI had received requests/suggestions to bring about clarifications on certain provisions of the clause. After examining the same, it has been decided to modify the existing Clause 49 by including the following provisions:

Mandatory provisions:

1. If the non-executive Chairman is a promoter or is related to promoters or persons occupying management positions at the board level or at one level below the board, at least one-half of the board of the company should consist of independent directors.
2. Disclosures of relationships between directors inter-se shall be made in specified documents/filings.
3. The gap between resignation/removal of an independent director and appointment of another independent director in his place shall not exceed 180 days. However, this provision would not apply in case a company fulfils the minimum

requirement of independent directors in its Board, i.e., one-third or one-half as the case may be, even without filling the vacancy created by such resignation/removal.

4. The minimum age for independent directors shall be 21 years.

Non-mandatory provisions:

The company shall ensure that the person who is being appointed as an independent director has the requisite qualifications and experience which would be of use to the company and which, in the opinion of the company, would enable him to contribute effectively to the company in his capacity as an independent director.

In view of the above, certain changes have to be incorporated in Clause 49, details of which are placed in Annexure I.

## II. Advice to Stock Exchanges

1. All Stock Exchanges are advised to:

a. Give effect to the abovementioned policies and appropriately amend Clause 49 of Equity Listing Agreement in line with the text of the amendments specified in Annexure I.

b. Make consequential changes, if any, in other clauses of Equity Listing Agreement.

2. All Stock Exchanges are further advised to communicate to SEBI, status of implementation of the requirements of this circular in the next Monthly Development Report.

III. This circular is issued in exercise of powers conferred by sub-section (1) of Section 11, read with sub-section (2) of Section 11A, of the Securities and Exchange Board of India Act, 1992, to protect the interests of investors in securities

***Guidance Note on Certification of Corporate Governance***

and to promote the development of, and to regulate the securities market.

IV. This circular is available on the SEBI website at [www.sebi.gov.in](http://www.sebi.gov.in).

Yours faithfully,

**ANNEXURE I to Circular dated April 08, 2008**

Clause 49 of the Listing Agreement shall be amended as follows –

1. In item (I),

(a) in para (A),

(i) after sub-clause (ii), the following proviso shall be inserted, namely:–

“Provided that where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.”

(ii) in sub-clause (iii),

(A) in point (e), the word “and” occurring after “director;” shall be omitted;

(B) after point (f), the following shall be inserted, namely:–

“(g) is not less than 21 years of age.”

(b) in para (C), after sub-clause (iii), the following sub-clause shall be inserted, namely:–

“(iv) An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director within a period of not more than 180 days from the day of such resignation or removal, as the case may be:

Provided that where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director within the period of 180 days shall not apply.”

2. In item (IV), in para (G), after sub-clause (i), the following sub-clause shall be inserted, namely: –

“(ia) Disclosure of relationships between directors inter-se shall be made in the Annual Report, notice of appointment of a director, prospectus and letter of offer for issuances and any related filings made to the stock exchanges where the company is listed.”

3. In Annexure 1D under the heading “Non-Mandatory Requirements”, for item no. 1, the following shall be substituted, namely:-

“1. The Board - A non-executive Chairman may be entitled to maintain a Chairman’s office at the company’s expense and also allowed reimbursement of expenses incurred in performance of his duties. Independent Directors may have a tenure not exceeding, in the aggregate, a period of nine years, on the Board of a company. The company may ensure that the person who is being appointed as an independent director has the requisite qualifications and experience which would be of use to the company and which, in the opinion of the company, would enable him to contribute effectively to the company in his capacity as an independent director.”

## **APPENDIX - K**

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**SEBI/CFD/DIL/CG/2/2008/23/10**  
**October 23, 2008**

**The Managing Director/Executive Director/Administrator  
of all the Stock Exchanges**

Dear Sir/Madam,

**Sub: Corporate Governance in listed Companies –  
Clause 49 of the Listing Agreement**

I. SEBI vide circular SEBI/CFD/DIL/CG/1/2008/08/04 dated April 08, 2008 amended Clause 49 of the Equity Listing Agreement inter-alia including a provision stating that if the non-executive Chairman is a promoter or is related to promoters or persons occupying management positions at the board level or at one level below the board, at least one-half of the board of the company should consist of independent directors.

SEBI had received queries requesting to bring about further clarity on the said amendment where the promoter of a listed company is a listed or unlisted entity. After examining the same, it has been decided to include the following explanation to the existing Clause 49.

In Item I, Para (A), in sub-clause (ii), after the proviso, the following Explanation shall be inserted, namely -:

Explanation-For the purpose of the expression “related to any promoter” referred to in sub-clause (ii):

a. If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;



b. If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.”

## **II. Applicability:**

The aforesaid amendments in Clause 49 of Equity Listing Agreement shall be implemented as per the schedule of implementation given below:

- (a) For entities seeking listing for the first time, at the time of seeking in-principle approval for such listing;
- (b) For existing listed entities which are required to comply with clause 49, before March 31, 2009.

## **III. Advice to Stock Exchanges:**

- 1. All Stock Exchanges are advised to:
  - a. Give effect to the abovementioned policies and appropriately amend Clause 49 of Equity Listing Agreement in line with the text of the amendments specified above.
  - b. Make consequential changes, if any, in other clauses of Equity Listing Agreement.
- 2. All Stock Exchanges are further advised to communicate to SEBI, status of implementation of the requirements of this circular in their quarterly report for the quarter ended March 31, 2009.

**III.** This circular is issued in exercise of powers conferred by sub-section (1) of Section 11, read with sub-section (2) of Section 11A, of the Securities and Exchange Board of India Act, 1992, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

***Guidance Note on Certification of Corporate Governance***

**IV.** This circular is available on the SEBI website at [www.sebi.gov.in](http://www.sebi.gov.in).

Yours faithfully,

# ANNEXURE - I

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## Clause 49 - Corporate Governance – Text of the Full Circular as amended upto 23rd October, 2008

The company agrees to comply with the following provisions:

### I. Board of Directors

#### (A) Composition of Board

(i) The Board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors.

(ii) Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors.

Provided that where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors<sup>45</sup>

Explanation:

For the purpose of the expression “related to any promoter” referred to in sub-clause (ii):

a. If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;

b. If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.<sup>46</sup>

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<sup>45</sup> SEBI/CFD/DIL/CG/1/2008/08/04 dated April, 08, 2008

<sup>46</sup> SEBI/CFD/DIL/CG/2/2008/23/10 October 23, 2008

### **Guidance Note on Certification of Corporate Governance**

(iii) For the purpose of the sub-clause (ii), the expression 'independent director' shall mean a non-executive director of the company who:

(a) apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;

(b) is not related to promoters or persons occupying management positions at the board level or at one level below the board;

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

(d) is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:

(i) the statutory audit firm or the internal audit firm that is associated with the company, and

(ii) the legal firm(s) and consulting firm(s) that have a material association with the company.

(e) is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director; and

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

(g) *is not less than 21 years of age.*<sup>47</sup>

**Explanation:** For the purposes of the sub-clause (iii):

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

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<sup>47</sup> Amendment by way of Circular SEBI/CFD/DIL/CG/1/2008/08/04 dated April, 08, 2008

(b) “Senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

(c) “Relative” shall mean “relative” as defined in section 2(41) and section 6 read with Schedule IA of the Companies Act, 1956.

(iv) Nominee directors appointed by an institution which has invested in or lent to the company shall be deemed to be independent directors.

**Explanation:** “Institution’ for this purpose means a public financial institution as defined in Section 4A of the Companies Act, 1956 or a “corresponding new bank” as defined in section 2(d) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 [both Acts].”

#### **(B) Non Executive Directors’ Compensation and Disclosures**

All fees / compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in general meeting. The shareholders’ resolution shall specify the limits for the maximum number of stock options that can be granted to non-executive directors, including independent directors, in any financial year and in aggregate.

<sup>48</sup>Provided that the requirement of obtaining prior approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 1956 for payment of sitting fees without approval of the Central Government.

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<sup>48</sup> Inserted by SEBI Circular dt. 13<sup>th</sup> January, 2006 – See Appendix F at Page Nos 51 - 52

**(C) Other Provisions as to Board and Committees**

(i) The board shall meet at least four times a year, with a maximum time gap of four months<sup>49</sup> between any two meetings. The minimum information to be made available to the board is given in Annexure– I A.<sup>50</sup>

(ii) A director shall not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director. Furthermore it should be a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

**Explanation:**

1. For the purpose of considering the limit of the committees on which a director can serve, all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies and companies under Section 25 of the Companies Act shall be excluded.
  2. For the purpose of reckoning the limit under this sub-clause, Chairmanship / membership of the Audit Committee and the Shareholders' Grievance Committee alone shall be considered.
- (iii) The Board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.
- (iv) *An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director within a period of not more than 180 days from the day of such resignation or removal as the case may be:*

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<sup>49</sup> Substituted in place of 'three months' by SEBI Circular dt. 13<sup>th</sup> January, 2006 – See Appendix F at Page Nos 51 - 52.

<sup>50</sup> Page Nos. 70 - 71

Provided that where the company fulfills the requirements of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director within the period of 180 days shall not apply.<sup>51</sup>

#### **(D) Code of Conduct**

(i) The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.

(ii) 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 by the CEO.

**Explanation:** For this purpose, the term “senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors.. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

## **II. Audit Committee**

### **(A) Qualified and Independent Audit Committee**

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

- (i) The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
- (ii) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

**Explanation 1:** The term “financially literate” means the ability to read and understand basic financial statements

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51 SEBI Circular NO. SEBI/CFD/DIL/CG/1/2008/08/04 dated April 8, 2008

## **Guidance Note on Certification of Corporate Governance**

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.

- (iii) The Chairman of the Audit Committee shall be an independent director;
- (iv) The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;
- (v) The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;
- (vi) The Company Secretary shall act as the secretary to the committee.

### **(B) Meeting of Audit Committee**

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

### **(C) Powers of Audit Committee**

The audit committee shall have powers, which should include the following:



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

**(D) Role of Audit Committee**

The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
4. Reviewing, with the management, the annual financial statements before submission to the board for approval, with particular reference to:
  - (a) Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (2AA) of section 217 of the Companies Act, 1956
  - (b) Changes, if any, in accounting policies and practices and reasons for the same
  - (c) Major accounting entries involving estimates based on the exercise of judgment by management d. Significant adjustments made in the financial statements arising out of audit findings
  - (d) Compliance with listing and other legal requirements relating to financial statements

## **Guidance Note on Certification of Corporate Governance**

- (e) Disclosure of any related party transactions
  - (f) Qualifications in the draft audit report.
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval
- 5A Reviewing, with the management the statement of uses/application of funds raised through an issue (public issue, rights issue, preferential issue, etc), the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter<sup>52</sup>*
6. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.
7. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
8. Discussion with internal auditors any significant findings and follow up there on.
9. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
10. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

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<sup>52</sup> SEBI/CFD/DIL/LA/4/2007/27/12 dated 27<sup>th</sup> December, 2007

11. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
12. To review the functioning of the Whistle Blower mechanism, in case the same is existing.
13. Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

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

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

#### **(E) Review of Information by Audit Committee**

The Audit Committee shall mandatorily review the following information:

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

### **III. Subsidiary Companies**

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

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

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

**Explanation 1:** The term “material non-listed Indian subsidiary” shall mean an unlisted subsidiary, incorporated in India, whose turnover or net worth (i.e. paid up capital and free reserves) exceeds 20% of the consolidated turnover or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

**Explanation 2:** The term “significant transaction or arrangement” shall mean any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the material unlisted subsidiary for the immediately preceding accounting year.

**Explanation 3:** Where a listed holding company has a listed subsidiary which is itself a holding company, the above provisions shall apply to the listed subsidiary insofar as its subsidiaries are concerned.

### **IV. Disclosures**

#### **(A) Basis of related party transactions**

(i) A statement in summary form of transactions with related parties in the ordinary course of business shall be placed periodically before the audit committee.

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

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

**(B) Disclosure of Accounting Treatment**

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

**(C) Board Disclosures – Risk management**

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 management controls risk through means of a properly defined framework.

**(D) Proceeds from public issues, rights issues, preferential issues etc.**

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

## **Guidance Note on Certification of Corporate Governance**

*monitoring agency to monitor the utilization of proceeds of a public or rights issue, it shall place before the Audit Committee the monitoring report of such agency, upon receipt, without any delay*<sup>53</sup>. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

### **(E) Remuneration of Directors**

(i) All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company shall be disclosed in the Annual Report.

(ii) Further the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report:

- (a) All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc.
- (b) Details of fixed component and performance linked incentives, along with the performance criteria.
- (c) Service contracts, notice period, severance fees.
- (d) Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

(iii) The company shall publish its criteria of making payments to non-executive directors in its annual report. Alternatively, this may be put up on the company's website and reference drawn thereto in the annual report.

(iv) The company shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report.

(v) Non-executive directors shall be required to disclose their shareholding (both own or held by / for other persons on a beneficial basis) in the listed company in which they are proposed

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<sup>53</sup> SEBI/CFD/DIL/LA/4/2007/27/12 dated 27<sup>th</sup> December, 2007

to be appointed as directors, prior to their appointment. These details should be disclosed in the notice to the general meeting called for appointment of such director.

**(F) Management**

(i) As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company's competitive position:

- (i) Industry structure and developments.
- (ii) Opportunities and Threats
- (iii) Segment-wise or product-wise performance
- (iv) Outlook
- (v) Risks and concerns
- (vi) Internal control systems and their adequacy
- (vii) Discussion on financial performance with respect to operational performance
- (viii) Material developments in Human Resources / Industrial Relations front, including number of people employed.

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

**Explanation:** For this purpose, the term "senior management" shall mean personnel of the company who are members of its core management team excluding the Board of Directors).

This would also include all members of management one level below the executive directors including all functional heads.

**(G) Shareholders**

(i) In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information:

- (a) A brief resume of the director;
- (b) Nature of his expertise in specific functional areas;
- (c) Names of companies in which the person also holds the directorship and the membership of Committees of the Board; and
- (d) Shareholding of non-executive directors as stated in Clause 49 (IV) (E) (v) above
- (e) *Disclosure of relationships between directors inter-se shall be made in the Annual Report, notice of appointment of a director, prospectus and letter of offer for issuances and any related filings made to the stock exchanges where the company is listed.*<sup>54</sup>

(ii) Quarterly results and presentations made by the company to analysts shall be put on company's web-site, or shall be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own web-site.

(iii) A board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders / Investors Grievance Committee'.

(iv) To expedite the process of share transfers, the Board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

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<sup>54</sup> SEBI Circular NO. SEBI/CFD/DIL/CG/1/2008/08/04 dated April 8, 2008



## V. CEO / CFO Certification

The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that:

- (a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :
  - (i) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
  - (ii) these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.
- (b) There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.
- (c) They accept responsibility for establishing and maintaining internal controls for financial reporting<sup>55</sup> and that they have evaluated the effectiveness of the internal control systems of the company pertaining to financial reporting<sup>56</sup> and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.
- (d) They have indicated to the auditors and the Audit committee
  - (i) significant changes in internal control over financial

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<sup>55</sup> Inserted by SEBI Circular dt 13<sup>th</sup> January, 2006 – See Appendix F at Page Nos 57 - 58

<sup>56</sup> Inserted by SEBI Circular dt 13<sup>th</sup> January, 2006 - See Appendix F at Page Nos 57 - 58

## **Guidance Note on Certification of Corporate Governance**

reporting<sup>57</sup> during the year;

- (ii) significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
- (iii) instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting<sup>58</sup>.

### **VI. Report on Corporate Governance**

(i) There shall be a separate section on Corporate Governance in the Annual Reports of company, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirement of this clause with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted. The suggested list of items to be included in this report is given in Annexure- I C<sup>59</sup> and list of non-mandatory requirements is given in Annexure – I D<sup>60</sup>.

(ii) The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format given in Annexure I B<sup>61</sup>. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company

### **VII. Compliance**

(1) The company shall obtain a certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same

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<sup>57</sup> Inserted by SEBI Circular dt 13<sup>th</sup> January, 2006 - See Appendix F at Page Nos 57 - 58

<sup>58</sup> Inserted by SEBI Circular dt 13<sup>th</sup> January, 2006 - See Appendix F at Page Nos 51 - 52

<sup>59</sup> See Page Nos 74 - 76

<sup>60</sup> See Page Nos 77 - 78

<sup>61</sup> See Page Nos 72 - 73

certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.

(2) The non-mandatory requirements given in Annexure – I D<sup>62</sup> may be implemented as per the discretion of the company. However, the disclosures of the compliance with mandatory requirements and adoption (and compliance) / non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report.

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<sup>62</sup> See Page Nos 104 - 105

## **ANNEXURE - IA**

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### **Information to be placed before Board of Directors**

1. Annual operating plans and budgets and any updates
2. Capital budgets and any updates
3. Quarterly results for the company and its operating divisions or business segments
4. Minutes of meetings of audit committee and other committees of the board
5. The information on recruitment and remuneration of senior officers just below the board level, including appointment or removal of Chief Financial Officer and the Company Secretary
6. Show cause, demand, prosecution notices and penalty notices which are materially important
7. Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems
8. Any material default in financial obligations to and by the company, or substantial nonpayment for goods sold by the company
9. Any issue, which involves possible public or product liability claims of substantial nature, including any judgment or order which, may have passed strictures on the conduct of the company or taken an adverse view regarding another enterprise that can have negative implications on the company
10. Details of any joint venture or collaboration agreement
11. Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property
12. Significant labour problems and their proposed solutions. Any

significant development in Human Resources / Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc

13. Sale of material nature, of investments, subsidiaries, assets, which is not in normal course of business
14. Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material
15. Non-compliance of any regulatory, statutory or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.

## ANNEXURE - IB

### Format of Quarterly Compliance Report on Corporate Governance

Name of the Company:

Quarter ending on:

| Particulars   | Clause of Listing Agreement | Compliance Status<br>Yes / No | Remarks |
|---|-----------------------------|-------------------------------|---------|
| <b>I. Board of Directors</b>                            | 49 I                        |                               |         |
| (A) Composition of Board                                | 49(IA)                      |                               |         |
| (B) Non-executive Directors' compensation & disclosures | 49 (IB)                     |                               |         |
| (C) Other provisions as to Board and Committees         | 49 (IC)                     |                               |         |
| (D) Code of Conduct 49(ID)                              |                             |                               |         |
| <b>II. Audit Committee</b>                              | 49 (II)                     |                               |         |
| (A) Qualified & Independent Audit Committee             | 49 (IIA)                    |                               |         |
| (B) Meeting of Audit Committee                          | 49 (IIB)                    |                               |         |
| (C) Powers of Audit Committee                           | 49 (IIC)                    |                               |         |
| (D) Role of Audit Committee                             | 49 (IIE)                    |                               |         |

|  |          |  |  |
|--|----------|--|--|
| <b>III. Subsidiary Companies</b>   | 49 (IV)  |  |  |
| <b>IV. Disclosures</b>   | 49 (IV)  |  |  |
| (A) Basis of related party transactions                                  | 49 (IVA) |  |  |
| (B) Board Disclosures  | 49 (IVB) |  |  |
| (C) Proceeds from public issues, rights issues, preferential issues etc. | 49 (IVC) |  |  |
| (D) Remuneration of Directors  | 49 (IVD) |  |  |
| (E) Management   | 49 (IVE) |  |  |
| (F) Shareholders   | 49 (IVF) |  |  |
| <b>V. CEO / CFO Certification</b>  | 49 (V)   |  |  |
| <b>VI. Report on Corporate Governance</b>                                | 49 (VI)  |  |  |
| <b>VII. Compliance</b>   | 49 (VII) |  |  |

**Note:**

- (1) The details under each head shall be provided to incorporate all the information required as per the provisions of the Clause 49 of the Listing Agreement
- (2) In the column No.3, compliance or non-compliance may be indicated by Yes / No / N.A.. For example, if the Board has been composed in accordance with the Clause 49 I of the Listing Agreement, "Yes" may be indicated. Similarly, in case the company has no related party transactions, the words "N.A." may be indicated against 49 (IV A)

***Guidance Note on Certification of Corporate Governance***

- (3) In the remarks column, reasons for non-compliance may be indicated, for example, in case of requirement related to circulation of information to the shareholders, which would be done only in the AGM / EGM, it might be indicated in the "Remarks" column as – “will be complied with at the AGM”. Similarly, in respect of matters which can be complied with only where the situation arises, for example, "Report on Corporate Governance" is to be a part of Annual Report only, the words "will be complied in the next Annual Report" may be indicated.



# ANNEXURE - IC

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## **Suggested List of Items to be Included in the Report on Corporate Governance in the Annual Report of Companies**

1. **A brief statement on company's philosophy on code of governance.**
2. ***Board of Directors***
  - (i) Composition and category of directors, for example, promoter, executive, non-executive, independent non-executive, nominee director, which institution represented as lender or as equity investor
  - (ii) Attendance of each director at the Board meetings and the last AGM
  - (iii) Number of other Boards or Board Committees in which he / she is a member or Chairperson
  - (iv) Number of Board meetings held, dates on which held.
3. ***Audit Committee***
  - (i) Brief description of terms of reference
  - (ii) Composition, name of members and Chairperson
  - (iii) Meetings and attendance during the year.
4. ***Remuneration Committee***
  - (i) Brief description of terms of reference
  - (ii) Composition, name of members and Chairperson
  - (iii) Attendance during the year
  - (iv) Remuneration policy

## **Guidance Note on Certification of Corporate Governance**

- (v) Details of remuneration to all the directors, as per format in main report.

### **5. Shareholders Committee**

- (i) Name of non-executive director heading the committee
- (ii) Name and designation of compliance officer
- (iii) Number of shareholders' complaints received so far
- (iv) Number not solved to the satisfaction of shareholders
- (v) Number of pending complaints.

### **6. General Body meetings**

- (i) Location and time, where last three AGMs held
- (ii) Whether any special resolutions passed in the previous 3 AGMs
- (iii) Whether any special resolution passed last year through postal ballot – details of voting pattern
- (iv) Person who conducted the postal ballot exercise
- (v) Whether any special resolution is proposed to be conducted through postal ballot
- (vi) Procedure for postal ballot.

### **7. Disclosures**

- (i) Disclosures on materially significant related party transactions that may have potential conflict with the interests of company at large
- (ii) Details of non-compliance by the company, penalties, strictures imposed on the company by Stock Exchange or SEBI or any statutory authority, on any matter related to capital markets, during the last three years
- (iii) Whistle Blower policy and affirmation that no personnel has been denied access to the audit committee

- (iv) Details of compliance with mandatory requirements and adoption of the non-mandatory requirements of this clause.

**8. Means of communication**

- (i) Quarterly results
- (ii) Newspapers wherein results normally published
- (iii) Any website, where displayed
- (iv) Whether it also displays official news releases; and
- (v) The presentations made to institutional investors or to the analysts.

**9. General Shareholder information**

- (i) AGM : Date, time and venue
- (ii) Financial year
- (iii) Date of Book closure
- (iv) Dividend Payment Date
- (v) Listing on Stock Exchanges
- (vi) Stock Code
- (vii) Market Price Data : High., Low during each month in last financial year
- (viii) Performance in comparison to broad-based indices such as BSE Sensex, CRISIL index etc.
- (ix) Registrar and Transfer Agents
- (x) Share Transfer System
- (xi) Distribution of shareholding
- (xii) Dematerialization of shares and liquidity

***Guidance Note on Certification of Corporate Governance***

- (xiii) Outstanding GDRs / ADRs / Warrants or any convertible instruments, conversion date and likely impact on equity
- (xiv) Plant Locations
- (xv) Address for correspondence

# ANNEXURE - ID

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## Non-Mandatory Requirements

### (1) The Board

A non-executive Chairman may be entitled to maintain a Chairman's office at the company's expense and also allowed reimbursement of expenses incurred in performance of his duties.

Independent Directors may have a tenure not exceeding, in the aggregate, a period of nine years, on the Board of a company. The company may ensure that the person who is being appointed as an independent director has the requisite qualifications and experience which would be of use to the company and which, in the opinion of the company and which, in the opinion of the company would enable him to contribute effectively to the company in his capacity as an independent director<sup>63</sup>.

### (2) Remuneration Committee

- (i) The board may set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment
- (ii) To avoid conflicts of interest, the remuneration committee, which would determine the remuneration packages of the executive directors may comprise of at least three directors, all of whom should be non-executive directors, the Chairman of committee being an independent director
- (iii) All the members of the remuneration committee could be present at the meeting

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<sup>63</sup> Amendment by way of Circular SEBI/CFD/DIL/CG/1/2008/08/04 dated April, 08, 2008

## ***Guidance Note on Certification of Corporate Governance***

- (iv) The Chairman of the remuneration committee could be present at the Annual General Meeting, to answer the shareholder queries. However, it would be up to the Chairman to decide who should answer the queries.

### **(3) Shareholder Rights**

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) Audit qualifications**

Company may move towards a regime of unqualified financial statements.

### **(5) Training of Board Members**

A company may train its 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.

### **(6) Mechanism for evaluating non-executive Board Members**

The performance evaluation of non-executive directors could be done by a peer group comprising the entire Board of Directors, excluding the director being evaluated; and Peer Group evaluation could be the mechanism to determine whether to extend / continue the terms of appointment of non-executive directors.

### **(7) Whistle Blower Policy**

The company may establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization.

