SUGGESTED ANSWERS

PROFESSIONAL PROGRAMME

GOVERNANCE, BUSINESS ETHICS AND SUSTAINABILITY

(PP-GBE&S/2010)

THE INSTITUTE OF
Company Secretaries of India
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These answers have been written by competent persons and the Institute hopes that the **SUGGESTED ANSWERS** will assist the students in preparing for the Institute's examinations. It is, however, to be noted that the answers are to be treated as model and not exhaustive answers and the Institute is not in any way responsible for the correctness or otherwise of the answers compiled and published herein.

The Suggested Answers contain the information based on the Laws/Rules applicable at the time of preparation. However, students are expected to be well versed with the amendments in the Laws/Rules made upto **six** months prior to the date of examination.

PROFESSIONAL PROGRAMME

GOVERNANCE, BUSINESS ETHICS AND SUSTAINABILITY

TEST PAPER 1/2010

(This Test Paper is based on Study Lessons I to IX)

Time allowed : 3 hours *Max. marks : 100*

NOTE : *Attempt any FIVE questions.*

Question No. 1

(a) Elucidate on the important recommendations of the Cadbury Committee Report with regard to the Board of Directors. (10 marks)

(b) Discuss in detail about the role of Board of Directors. (10 marks)

Answer to Question No. 1(a)

The 'Cadbury Committee' was set up in May 1991 by the Financial Reporting Council, the London Stock of Exchange and the accountancy profession, with the main aim of addressing the financial aspects of Corporate Governance. Other objectives include: (i) uplift the low level of confidence both in financial reporting and in the ability of auditors to provide the safeguards which the users of company's reports sought and expected; (ii) review the structure, rights and roles of board of directors, shareholders and auditors by making them more effective and accountable; (iii) address various aspects of accountancy profession and make appropriate recommendations, wherever necessary; (iv) raise the standard of corporate governance; etc.

The Committee recommends that the boards of all listed companies should comply with the Code of Best Practice. All listed companies should make a statement about their compliance with the Code in their report and accounts as well as give reasons for any areas of non-compliance.

1. *Board of Directors*

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

   (b) There should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision.

   (c) Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognized senior member, that is, there should be a lead independent director.

   (d) All directors should have access to the advice and services of the company secretary, who is responsible to the Board for ensuring that board procedures are followed and that applicable rules and regulations are complied with.

2. *Non-Executive Directors*

   (a) The non-executive directors should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct.

   (b) The majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment, apart from their fees and shareholding.

3. *Executive Directors*

   There should be full and clear disclosure of directors' total emoluments and those of the chairman and highest-paid directors, including pension contributions and stock options, in the company's annual report, including separate figures for salary and performance-related pay.

4. *Financial Reporting and Controls*

   It is the duty of the board to present a balanced and understandable assessment of their company's position, in reporting of financial statements, for providing true and fair picture of financial reporting. The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary. The board should ensure that an objective and professional relationship is maintained with the auditors.

Considering the role of Auditors and addressing a number of recommendations to the Accountancy Profession

Annual audit provides an external and objective check on the way in which the financial statements have been prepared and presented by the directors of the company. The Cadbury Committee recommended that a professional and objective relationship between the board of directors and auditors should be maintained, so as to provide to all a true and fair view of company's financial statements. Every listed company should form an audit committee which gives the auditors direct access to the non-executive members of the board.

The Committee further recommended for a regular rotation of audit partners to prevent unhealthy relationship between auditors and the management.

The Accountancy Profession, in conjunction with representatives of preparers of accounts, should take the lead in: (i) developing a set of criteria for assessing effectiveness; (ii) developing guidance for companies on the form in which directors should report; and (iii) developing guidance for auditors on relevant audit procedures and the form in which auditors should report.

Dealing with the Rights and Responsibilities of Shareholders

The shareholders, as owners of the company, elect the directors to run the business on their behalf and hold them accountable for its progress. They appoint the auditors to provide an external check on the directors' financial statements. The Committee's report

places particular emphasis on the need for fair and accurate reporting of a company's progress to its shareholders, which is the responsibility of the board.

Both shareholders and boards of directors should consider how the effectiveness of general meetings could be increased as well as how to strengthen the accountability of boards of directors to shareholders.

Answer to Question No. 1(b)

Good governance demands transparency, disclosure accountability, issues of sustainability, corporate citizenship. Considering this the board of directors play a pivotal role by ensuring leadership, vision, strategy, monitoring, supervision and accountability to shareholders and other stakeholders The role of the Board of Directors is discussed as under:

To Establish an Organizational Vision and Mission

Organization's activities should be consistent with its stated purpose and effectively and efficiently work towards achieving its mission and be committed to continual quality improvement. Based on the value of quality, openness, integrity, responsibility and accountability, board members and employees should act in the best interest of achieving the organizations mission at all times.

Giving strategic direction and advice

Boards are in an excellent position to provide input and advice to the CEO and the top management regarding the company's strategic direction. They can contribute opinions, viewpoints and information that are not always readily available to the company's management and provide out of box view for potential effectiveness.

Overseeing Strategy implementation and performance

The board plays a crucial role in advising, evaluating and monitoring strategy implementation. Boards can best monitor strategy implementation by setting benchmarks to measure progress and by drawing on objective sources of information.

Developing and evaluating the CEO

The evaluation of CEO and top management team is a very important activity of the board. In the rapidly changing environment, boards need to be proactive in evaluating the performance of CEO and top management team.

To Ensure the Organization has Sufficient and Appropriate Human Resources

The Board has to be involved in planning the development of senior management by performing following activities:

(a) Hiring the senior staff person

(b) Giving direction to the senior staff person, and;

(c) Evaluating the senior staff person.

Ensuring Effective stakeholder Relations

— Board serves as a communication bridge between the members and others involved in an organization. An organization can accomplish this by informing

people of upcoming events, promoting items of interest and providing newsworthy information.

— It is a communication link with the general public. Promote the organizations purpose, goals and objectives, programs and activities before the public to foster awareness, accomplishments and opportunities for involvement.

Risk Mitigation

Directors are expected to identify and manage obstacles that may prevent the organisation from reaching its goals .Directors have a responsibility to owners to foresee what could affect the organisation and to make sure plans are in place that will minimise the impact of events or changes that will have a negative effect.

Procuring resources

Financial resources, human resources, technological resources, business relationship are the key resources that are essential to an organization's success. Boards play an important role in helping the organization procuring the resources.

Question No. 2

(a) *"Chairmen have no legal position". Elucidate this statement and describe the role of Chairman of Board.* *(10 marks)*

(b) *Discuss in detail the need to separate the roles of Chairman and Managing Director.* *(10 marks)*

Answer to Question No. 2(a)

Chairman is the person who leads the board meetings. Though, he is the leader of the board, he has no legal position. Chairman is elected by the board to take the chair at a particular meeting, particularly for administrative convenience and proper conduct of the meeting. Statutorily boards are not bound to continue the same chairman in successive meetings. Competence of chairmanship is crucial for the effectiveness of the board; otherwise meeting ends up in frustration and waste of time.

The role of the chairman includes the following:

(a) Setting the board agenda, ensuring that directors receive accurate, timely and clear information to enable them to take sound decisions and encouraging active involvement of all members of the board;

(b) Actively leading the induction programme for new directors and addressing to development of skills and knowledge of individual directors;

(c) Annual evaluation of the performance of each director of the board, performance of the board as a whole and performance of the committees of the board;

(d) Ensuring effective communication with shareholders, particularly with principal shareholders on matters relating to strategy, governance and director remuneration.

Institute of Directors laid the following main feature of the role of Chairman in a company

(a) Chairman acts as a representative of company's aims and policies to the outside world,

(b) To take the chair at the Board meetings and General meeting involving

I. Determination of the order of the agenda;

II. Ensuring that the board receives proper information;

III. Tracking contribution of individual directors and ensuring that they are involved in discussions and decision making.

IV. To take lead role in determining the composition and structure of the Board, maintaining balance between executive and non executive directors.

Although board chairman has no legal position yet chairman plays a crucial role in developing a focused board.

Answer to Question No. 2(b)

Role of the chairman and Managing director/CEO should be separate for the effective functioning of the company's board. The chairman and the board are responsible for monitoring and evaluating the performance of the company, while the managing director represent the management team. So, it requires that the roles are performed by two different persons, thereby increasing the accountability of Managing Director.

A clear demarcation of their roles ensure proper balance of power. Following are the benefits of separation of roles of Chairman and Managing Director:

(a) *Director communication* : A separate chairman provides a more effective channel for the board to express its views on management.

(b) *Guidance* : A separate chairman can provide the CEO with guidance and give feedback on the performance of the Managing Director.

(c) *Shareholders' interest* : The chairman can focus on shareholders interest and the CEO can manage the company.

(d) *Governance* : A separate chairman allows the board to more effectively fulfill its regulatory requirements.

(e) *Long term outlook* : The chairman can focus on the long term strategy while CEO can focuses on short term profitability.

(f) *Succession Planning* : A separate chairman can more effectively focus on corporate succession plans.

Question No. 3

(a) Elaborate on the role of Audit Committee. *(10 marks)*

(b) "Briefly discuss the legal provisions with regard to the constitution of remuneration committee. *(10 marks)*

Answer to Question No. 3(a)

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
   - (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
6. Reviewing, with the management, performance of statutory and internal auditors, and 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 areas 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.

Answer to Question No. 3(b)

Remuneration Committee is constituted by a company to determine the remuneration packages of executive and directors, based on their performance .

Constitution of Remuneration Committee is a non-mandatory requirement in terms of Clause 49 of the Listing Agreement. It states :

(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.

(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.

In terms of SEBI (Employees Stock Option Scheme and Employees Stock Purchase Scheme) Guidelines, 1999, a company that wishes to offer its shares under ESOP/ESP Scheme, has to constitute a Compensation Committee. Clause 5 of the said Guidelines provides as under:

1. No ESOS shall be offered unless the disclosures, as specified in Schedule IV, are made by the company to the prospective option grantees and the company constitutes a Compensation Committee for administration and superintendence of the ESOS.
2. The Compensation Committee shall be a Committee of the Board of Directors consisting of a majority of independent directors.
3. The Compensation Committee shall formulate the detailed terms and conditions of the ESOS
4. The Compensation Committee shall frame suitable policies and systems to ensure that there is no violation of,—

   (a) the Securities and Exchange Board of India (Insider Trading) Regulations, 1992; and

(b) the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 1995, by any employee.

In addition to this, the payment of remuneration as per Schedule XIII to the Companies Act the appointment of Managing Director without Central Government's approval requires that the payment of the remuneration is approved by a resolution passed by the remuneration Committee.

To conclude, remuneration committee is not a mandatory committee in terms of Clause 49 of the Listing Agreement, it is recommended that a company constitute remuneration committee for better governance.

Question No. 4

(a) Describe the various ways in which risks can be handled. (10 marks)

(b) Elaborate on the COSO Framework of Internal Control. (10 marks)

Answer to Question No. 4(a)

Handling of risk in a proper manner help in organization's growth and the economy. Firms are not entirely free to decide on how they shall handle their risks. The Central Government and State Governments have enacted compulsory insurance regulations. And in addition a firm may be obliged to insure certain risks under provisions of leases, construction and other contracts. Failure to comply with both safety and compulsory insurance regulations may constitute a criminal offence and may lead to the closure of a plant or other establishments. It is though up to the Board of the company to exercise its own discretion to control physical or financial loss or to say manage risk.

Risks can be handled broadly in following four ways:

Risk Avoidance

It is a rare possibility to avoid a risk completely. A riskless situation is rare. Generally risk avoidance is only feasible at the planning stage of an operation.

Risk Reduction

In many ways physical risk reduction (or loss prevention, as it is often called) is the best way of dealing with any risk situation and usually, it is possible to take steps to reduce the probability of loss. Again, the ideal time to think of risk reduction measures is at the planning stage of any new project when considerable improvement can be achieved at little or no extra cost. Risk prevention generally should be evaluated in the same way as other investment projects.

Risk Retention

It is also known as risk assumption or risk absorption. It is the most common risk management technique. This technique is used to take care of losses ranging from minor to major break-down of operation. There are two types of retention methods for containing losses as under:

(i) Risk retained as part of deliberate management strategy after conscious evaluation of possible losses and causes. This is known as active form of risk retention.

(ii) Risk retention occurred through negligence. This is known as passive form of risk retention.

Risk Transfer

This refers to legal assignment of cost of certain potential losses to another. The insurance of 'risks' is to occupy an important place, as it deals with those risks that could be transferred to an organization that specializes in accepting them, at a price.

Answer to Question No. 4(b)

COSO's Internal Control Framework

Internal control consists of five interrelated components. The components are:

— Control Environment

— Risk Assessment

— Control Activities

— Information and Communication

— Monitoring

Control Environment

It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors includes:

— the integrity, ethical values and competence of the people who form the backbone of the organisation;

— management's philosophy and operating style;

— the way management assigns authority and responsibility, and organises and develops its people;

— and the attention and direction provided by the Board of Directors.

Risk Assessment

Every entity faces a variety of risks from external and internal sources that must be assessed. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed.

Control Activities

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions.

Information and Communication

Relevant information must be identified, captured and communicated in a form and

timeframe that enable people to carry out their responsibilities. Information systems produce reports, containing operational, financial and compliance-related information, which make it possible to run and control the business. Effective communication must flow across, down and up in the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others.

Monitoring

Internal control systems need to be monitored—a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties.

Question No. 5

Discuss about the disclosures that are required to be made in terms of Clause 49 of the Listing Agreement. *(20 marks)*

Answer to Question No. 5

SEBI under clause 49 requires the listed companies to include a separate report on Corporate Governance in their Annual Report. The disclosures on Corporate Governance are as under

— Disclosures on mandatory requirements

— Disclosures on non mandatory requirements.

Disclosures about mandatory requirements

Disclosure on Remuneration of Directors

Clause 49-I(B) clearly states that 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 the 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.

The following disclosures on the remuneration of directors shall also be included in the section of corporate governance

— All elements of remuneration package of individual directors.

— Details of fixed component and performance linked incentives, along with the performance criteria.

— Service contracts, notice period, severance fees.

— Stock option details, if any – and whether issued at a discount as well as the period.

— The company shall publish its criteria of making payments to non-executive directors in its annual report.

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

— 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

Disclosure of Non-Executive Directors' Pecuniary Relationship or Transactions

"Pecuniary relationship or transaction" refers to any relationship or transaction of a director with the company which gets him any monetary benefit, reward, remuneration including remuneration for directorship in whatever form. Under clause 49-IV(E) all such transactions should be disclosed in the Annual report of the company.

Disclosure of Basis of related party transactions

Clause 49-IV(A) states that a statement in summary form of transactions with related parties in the ordinary course of business shall be placed periodically before the audit committee. Further details of material individual transactions with related parties which are not in the normal course of business shall be placed before the audit committee. 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.

Disclosure of Accounting Treatment

Clause 49-IV(B) provides that, 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 managements' 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.

It further requires that the deviations in accounting standards be also reported in Corporate Governance Report with an explanation why Board believes alternative treatment is more representative of the true and fair view of underlying business transaction.

Board Disclosures - Risk Management

Clause 49-IV(C) provides that the company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. It further provides that every company must have a system to inform the Board about the risk assessment and minimization procedures. Such a system should be periodically reviewed to ensure that the management has been taking measures to control and minimize the risks.

Proceeds from public issues, rights issues, preferential issues, etc.

As per clause 49-IV(D), when money is raised through an issue (public issues, rights issues, preferential issues etc.) it shall disclose to the Audit Committee the uses/application 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.

Management

A Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This shall include discussion on the following matters within the limits set by the company's competitive position:

1. Industry structure and developments.
2. Opportunities and Threats.
3. Segment–wise or product-wise performance.
4. Outlook
5. Risks and concerns.
6. Internal control systems and their adequacy.
7. Discussion on financial performance with respect to operational performance.
8. Material developments in Human Resources / Industrial Relations front, including number of people employed.

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 shareholders.

Disclosure to Board about the interest of Members of Senior Management

Under Clause 49-IV(F)(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 shareholders.

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.

Disclosure to Shareholders

Clause 49-IV(G)(i) states that the following information relating to appointment of a new director or reappointment of a director must be provided to the shareholders:

(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 directorship and the membership Board of Committees of the Board; and
(d) Shareholding of non-executive directors as stated in clause 49IV(E)(v) above.

The company should disclose in the Annual Report details of officer or committee or the Registrar and Share Transfer Agents to whom request can be made for transfer of shares.

Disclosure of Relationships between Directors

Clause 49-IV(G)(ia) provides for the disclosure of relationships between directors inter-se, which 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.

Disclosure of certain Information on Website

As per Clause 49-IV(G)(ii), the company should place the following information on its website :

(a) Quarterly results.

(b) Presentation made by the company to analysts.

Alternatively, the details 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 website.

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 and that they have evaluated the effectiveness of the internal control systems of the company pertaining to financial reporting.

(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.

Report on Corporate Governance

Clause 49-VI provides that there shall be a separate section on Corporate Governance in the annual Reports of Company, with a detailed compliance report on Corporate Governance. The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the following format. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company.

Disclosures relating to non-mandatory requirements

The half-yearly declaration of financial performance including summary of the significant events in last six months may be sent to each household of shareholders. However, companies generally post their half-yearly and quarterly results on their websites and advertise through newspapers. Some companies send half-yearly results to each household of shareholders.

The company should disclose in the Report on Corporate Governance whether it has sent to each household of shareholders half-yearly report on financial performance including summary of the significant events which occurred in the last six months.

Question No. 6

(a) Elaborate on the factors responsible for increasing attention being devoted to Corporate Social Responsibility by Corporates. (10 marks)

(b) Describe how shareholder activism can influence the corporate functioning. (10 marks)

Answer to Question No. 6(a)

The term Corporate Social responsibility refers to the concept of business being accountable for how it manages the impact of its processes on stakeholders and takes responsibility for producing a positive effect on society. CSR has been defined as the continuing commitment by business to behave fairly and responsibly and contribute to economic development while improving the quality of life of the workforce and their families as well as the local community and society at large.

The following are the few factors and influences which have led to increasing attention being devoted to Corporate Social Responsibility (CSR) by the corporates:

(a) Globalization – coupled with focus on cross-border trade, multinational enterprises and global supply chains — is increasingly raising CSR concerns related to human resource management practices, environmental protection, and health and safety, among other things.

(b) Governments and intergovernmental bodies, such as the United Nations, the Organisation for Economic Co-operation and Development and the International Labour Organization have developed compacts, declarations, guidelines, principles and other instruments that outline social norms for acceptable conduct.

(c) Advances in communications technology, such as the Internet, cellular phones and personal digital assistants, are making it easier to track corporate activities and disseminate information about them. Non-governmental organizations now

regularly draw attention through their websites to business practices they view as problematic.

(d) Consumers and investors are showing increasing interest in supporting responsible business practices and are demanding more information on how companies are addressing risks and opportunities related to social and environmental issues.

(e) Numerous serious and high-profile breaches of corporate ethics have contributed to elevated public mistrust of corporations and highlighted the need for improved corporate governance, transparency, accountability and ethical standards.

(f) Citizens in many countries are making it clear that corporations should meet standards of social and environmental care, no matter where they operate.

(g) There is increasing awareness of the limits of government legislative and regulatory initiatives to effectively capture all the issues that corporate social responsibility addresses.

(h) Businesses are recognizing that adopting an effective approach to CSR can reduce risk of business disruptions, open up new opportunities, and enhance brand and company reputation.

Corporate Social Responsibilty is about how a company align their values to social causes by including and collaborating with their investors, suppliers, employees, regulators and the society as a whole. CSR initiatives of a corporate is not a selfless act of giving; companies derive long-term benefits from the CSR initiatives

Answer to Question No. 6(b)

A share in a company is not only a share in profits but also a share in ownership. Shareholders must ensure their active participation in the company's operations. Shareholder activism refers to the active involvement of stockholders in their organization. Shareholders can ensure that the company follows good corporate governance practices and implements beneficial policies. They can resolve issues laid down in the annual and other general meetings and can raise concerns over financial matters or even social causes such as protection of the environment. Shareholder activists include public pension funds, mutual funds, unions, religious institutions, universities, foundations, environmental activists and human rights groups.

Shareholders have been granted certain rights under the Companies Act, 1956 such as

— right to vote on election of directors, changes in companies articles, and any other policy matters like compensation, salary, remuneration, sitting fees etc of directors;

— right to transfer and registration of shares;

— obtain relevant information on the company on timely and regular basis;

— electing members of the board;

— and share the residual profit.

The shareholder activism means

— Establishing dialogue with the management on issues that concern

— Influencing the corporate culture.

— Using the corporate democracy provided by law.

— Increasing general awareness on social and human rights issues concerning the organization.

Shareholder activism can be exercised through proxy battles, publicity campaigns, shareholder resolutions, litigation and negotiations with management. For example,

— Shareholder activism plays a major role in eradicating apartheid in South Africa through divestment.

— Shareholders have also influenced the phasing out of polystyrene products at McDonalds.

— More recently, shareholders were able to bring public pressure and media attention on Home Depot to stop the use of wood from environmentally sensitive areas.

— In India we have seen similar human rights movements on Dow Chemicals in the Bhopal gas leak case.

Most dissident shareholder proposals are focused on the following issues:

— Changes in corporate bylaws to allow for increased shareholder control/ participation in proxy matters

— Initiation or continuation of a share repurchase program or dividend.

— Cash hoarding companies have been pressed aggressively to return idle cash to investors.

— Nomination of new Director. Boards that are perceived to be entrenched, ineffective, unaccountable or unwilling to consider broader proposals brought to them including strategic alternatives are the most likely to see a nomination contest.

— Evaluation of strategic alternatives, including restructuring plans, cost-cutting initiatives and the like, the majority are focused on transactions.

Question No. 7

Write Short Notes on the following :

(i) CSR – A contract with society.

(ii) Continual Disclosure in terms of SEBI (Prohibition of Insider Trading) Regulations, 1992.

(iii) Compliance Certificate in terms of Clause 49 of Listing Agreement.

(iv) Performance review of Directors. *(5 marks each)*

Answer to Question No. 7(i)

Corporate Social Reponsibility : A contract with society

Sir Adrian Cadbury has described that the essence of the contract between society and business is that companies shall not pursue their immediate profit objectives at the expense of the long-term interests of the community. The broadest way of defining social responsibility is to say that the continued existence of companies is based on an implied agreement between business and society. The freedom of operation of companies is, therefore, dependent on their delivering whatever balance of economic and social benefits society currently expects of them. The problem for companies is that the balance of needs and benefits is continually changing and there is no generally accepted way of measuring those changes.

Companies are expected to meet society's demands for goods and services, to provide employment, to contribute to the exchequer, and to operate efficiently at a profit. There is no conflict between social responsibility and the obligation on companies to use scarce resources efficiently and to be profitable—an unprofitable business is a drain on society.

Answer to Question No. 7(ii)

Continual disclosure

Any person who holds more than 5% shares for voting rights in any listed company shall disclose to the company in the prescribed form the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below 5%, if there has been change in such holdings from the last disclosure made and such change exceeds 2% of total shareholding or voting rights in the company.

Any person who is a director or officer of a listed company, shall disclose to the company in the prescribed form, the total number of shares or voting rights held and change in shareholding or voting rights, if there has been a change in such holdings from the last disclosure made and the change exceeds Rs. 5 lakh in value or 25,000 shares or 1% of total shareholding or voting rights, whichever is lower.

These disclosures shall be made within 4 working days of:

(a) the receipts of intimation of allotment of shares, or

(b) the acquisition or sale of shares or voting rights, as the case may be.

Answer to Question No. 7(iii)

Compliance certificate

In terms of Clause 49 Listing agreement ,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. Such certificate is the Compliance Certificate.

Answer to Question No. 7(iv)

Performance review of Directors

A formal evaluation of the board and of the individual directors is one of the potentially effective way to respond to the demand for greater board accountability and effectiveness.Feedback about the performance of individual board members can help them enhance their skills and can motivate them to perform better. Following are the four areas where the performance improvement can be identified:

(a) more effective board operations;

(b) better team dynamics and communication;

(c) greater clarity with regard to member role and responsibilities and

(d) improved CEO- Board relations.

An effective board evaluation requires the right combination of timing, content, process, and individuals.

The performance of both the executive directors and non-executive directors need to be evaluated. Clause 49 provides for the mechanism for evaluating non-executive directors.

The performance of the board and its members should be evaluated and measured by the following parameters:

1. Performance of the Board against the performance benchmarks set
2. Overall value addition by the discussions taking place at the Board meetings.
3. The regularity and quality of participation in Board and committee meetings
4. The answerability of the top management to the board on the performance related matters.

TEST PAPER 2/2010

(This Test Paper is based on Study Lessons Xto XV)

Time allowed : 3 hours *Max. marks : 100*

NOTE : *Attempt any FIVE questions.*

Question No. 1

Write short notes on :

(i) Social and ethical accounting.

(ii) Relationship between organization structure and ethics.

(iii) United Nations Conference on Environment

(iv) Life cycle assessment. *(5 marks each)*

Answer to Question No. 1(i)

Social and Ethical Accounting

Social and ethical accounting is a process that helps a company to address issues of accountability to stakeholders, and to improve performance of all aspects i.e. social, environmental and economic. The process normally links a company's values to the development of policies and performance targets and to the assessment and communication of performance.

Social and ethical accounting has no standardized model. There is no standardized balance sheet or unit of currency. The issues are defined by the company's values and aims by the interests and expectations of its stakeholders, and by societal norms and regulations. Social and ethical accounting framework concerns with the issues such as economic performance, working conditions, environmental and animal protection, human rights, fair trade and ethical trade, human resource management and community development, and hence with the sustainability of a company's activities. The nature of social and ethical accounting is related to the size and nature of the organization.

Answer to Question No. 1(ii)

Organisation Structure & Ethics

An organization's structure is important to the study of business ethics. In a Centralized organization, decision-making authority is concentrated in the hands of top-level managers, and little authority is delegated to lower levels. Responsibility, both internal and external, rests with top management. This structure is especially suited for organizations that make high-risk decisions and whose lower-level managers are not highly skilled in decision making.Their code of ethics may specify the techniques to be used for decision making.

In a decentralized organization, decision-making authority is delegated as far down the chain of command as possible. Such organizations have relatively few formal rules, and coordination and control are usually informal and personal. They focus instead on increasing the flow of information. One of the strengths is the adaptability and early recognition of external change while the weakness is that it is difficult for such organizations to respond quickly to the policy change established by the top management.

Answer to Question No. 1(iii)

United Nations Conference on the Human Environment

The United Nations Conference on the Human Environment (also known as the Stockholm Conference) was an international conference convened under United Nations auspices held in Stockholm. It was the UN's first major conference on international environmental issues.

One of the key issues addressed was the use of Chlorofluorocarbons which seemed to be responsible for the depletion of the ozone layer. The Stockholm Conference laid framework for future environmental cooperation led to the creation of global and regional environmental monitoring networks and the creation of the United Nations Environment Programme.

Answer to Question No. 1(iv)

Life Cycle Assessment

Life Cycle Assessment (LCA) tracks the environmental impacts of a product from its raw materials through disposal at the end of its useful life. LCA is an important tool for developing an environmental self-portrait and for finding ways to minimize harm. A good LCA can shed light on ways to reduce the resources consumed and lower costs all along the value chain.

A Life Cycle Assessment looks at this complete circle and measures environmental impact at every phase. It provides the foundation for understanding the issues a company must address and clues to help find economic advantage.

Question No. 2

(a) Elucidate the importance of training and communication in an ethics programme. *(8 marks)*

(b) Explain the two fundamental principles with regard to stakeholder theory. *(8 marks)*

Answer to Question No. 2(a)

Ethics Training and Communication

A major step in developing an effective ethics program is implementing a training program and communication system to communicate and educate employees about the firm's ethical standards.

Training can educate employees about the firm's policies and expectations. Training programs can make employees aware of available resources, support systems, and

designated personnel who can assist them with ethical and legal advice. They can also empower employees to ask tough questions and make ethical decisions.

An effective ethics training must start at the foundation level, a code of ethics, highlighting the ethical issues should be communicated to the line and staff, and the executive.

For an effective ethic program following- Goals, Roles, Expectations, and Priorities should be communicated to the employees:

— Employees need to be frequently reminded of the short and long term goals of the job, so that employee's individual goals must support the organization's mission and vision. They should be made aware about how a goal is to be accomplished.

— Employees need to know how their job is important for the organisation and how they add value to the organization, to ensure that they understand what kind of conduct is expected from them.

— They should know about what exactly is expected from them, what is to be done, when, to what standards, how it is to be evaluated, what is to be done if they encounter any hurdle or unanticipated changes, how the conflicts is to be handled.

— Operational priorities of the organization should be clear in the minds of the employees.

For a successful, business ethics programs it should educate employees about formal ethical frameworks and more for analyzing business ethics issues and a written Ethical policy of the organization will deter wrongdoing and promote honesty and ethical conduct.

Answer to Question No. 2(b)

Freeman defined stakeholder as 'any group or individual who can affect or is affected by the achievement of the organization's objectives'. This concept was elaborated by Evans & Freeman as the following two principles:

1. **Principles of corporate legitimacy**

   The corporation should be managed for the benefit of its stakeholders: its customers, suppliers owners, employees & local communities. The rights of these groups must participate, in some sense, in decisions that substantially affect their welfare.

2. **The stakeholder fiduciary principle**

   Management bears a fiduciary relationship to stakeholders and to the corporation as an abstract entity. It must act in the interest of the stakeholders as their agent, and it must act in the interests of the corporation to ensure the survival of the firm, safeguarding the long-term stakes of each group.

Subsequently Freeman redefined stakeholder as "Those groups who are vital to the survival & success of the corporation" and the principles were altered renamed:

1. **The stakeholder enabling principle** : Corporations shall be managed in the interest of stakeholders.
2. **The principle of Director responsibility** : They shall have the duty to use reasonable judgement to define and direct the affairs of the corporation in accordance with the stakeholder enabling principle.

Question No. 3

(a) Elucidate the statement–Beyond Shareholders towards stakeholders. (8 marks)

(b) Explain in detail the concept of whistle-blower. (8 marks)

Answer to Question No. 3(a)

A shareholder is not only has a share in profit but also has share in ownership.

Customers, investors and shareholders, employees, suppliers, government agencies, communities, and many others who have a "stake" or claim in some aspect of a company's products, operations, markets, industry, and outcomes are known as stakeholders.

This clearly indicates that a shareholder included in the category of a stakeholder. Stakeholders provide resources that are more or less critical to a firm's long-term success. These resources may be both tangible and intangible. Shareholders, for example, supply capital; suppliers offer material resources or intangible knowledge; employees and managers grant expertise, leadership, and commitment; customers generate revenue and provide infrastructure; and the media transmits positive corporate images.

The underlining factor in the stakeholder concept is that every activity of an organization should be based taking into account the interests of all the stakeholders. A major reason for increasing adoption of a Stakeholder Concept in setting business objectives is the recognition that businesses are affected by the "environment" in which they operate. Businesses come into regular contact with various special interest groups. Decisions made by a business are likely to affect one or more of these "stakeholder groups".

The stakeholder concept suggests that the managers of a business should also, while taking decisions take into account their responsibilities towards stakeholders groups other than shareholders The concept suggests that businesses can benefit significantly from cooperating with stakeholder groups, incorporating their needs in the decision-making process.

Answer to Question No. 3(b)

A whistleblower is a person who publicly complains concealed misconduct on the part of an organization or body of people, usually from within that same organisation. This misconduct may be classified in many ways; for example, a violation of a law, rule, regulation and/or a direct threat to public interest, such as fraud, health/safety violations, and corruption. Whistleblowers frequently are likely to face retaliation - sometimes at the hands of the organisation or group which they have accused unless a system is in

place that would ensure confidentiality is maintained. It is in this context whistleblowers are often protected under law from employer retaliation. In India, clause 49 of the Listing Agreement provides as under with regard to Whistle Blower Policy:

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 this and also provide 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. This is a non-mandatory requirement. In case the whistle Blower mechanism is existing, the audit committee is responsible to review the functioning of the Whistle Blower mechanism.

Question No. 4

(a) Explain in detail the steps involved in resolving an ethical dilemma. (10 marks)

(b) Identify and explain the Ethical philosophy in each of the following situations :

(i) A man is driving a bus full of people on a steep road suddenly he sees a man crossing the road. If he were to apply brakes, the bus would skid and fall and the loss of lives and injuries would be many. Whereas, if he continues to drive he would hit the man who is crossing the road. He decides to continue driving. (3 marks)

(ii) An organization has a policy for providing continuing education for employees by fully sponsoring the fees, providing required leave and other facilities. However, the employees are required to sign a bond that they would continue working in the organization for at least five years or refund the expenses incurred by the organization towards the education programme. (3 marks)

Answer to Question No. 4(a)

An ethical dilemma is a situation that will often involve an apparent conflict between moral imperatives, in which to obey one would result in transgressing another. This is also called an ethical paradox.

Steps to Resolving an Ethical Dilemma are as follows:

1. What are the options ?

   List the alternative courses of action available.

2. Consider the consequences

   Think carefully about the range of positive and negative consequences associated with each of the different paths of action available.

   — Who/what will be helped by what is done ?

   — Who/what will be hurt ?

— What kinds of benefits and harms are involved and what are their relative values ?

— What are the short-term and long-term implications?

3. Analyse the actions

   Actions should be analysed in a different perspective i.e. viewing the action per se disregard the consequences, concentrating instead on the actions and looking for that option which seems problematic.

4. Make decision and act with commitment

   Now, both parts of analysis should be brought together and a conscious and informed decision should be made. Once the decision is made, act on the decision assuming responsibility for it.

5. Evaluate the system

   Think about the circumstances which led to the dilemma with the intention of identifying and removing the conditions that allowed it to arise.

Answer to Question No. 4(b)(i)

Deontological ethics or deontology is an approach to ethics that focuses on the rightness or wrongness of actions themselves, as opposed to the rightness or wrongness of the consequences of those actions. Thus, the term 'deontological' picked out the set of ethical theories that are based on the idea that an action's being right or wrong is basic, and whether a situation is good or bad depends on whether the action that brought it about was right or wrong. Here the driver has option between two actions one if he applies the brake the bus would skid causing life danger for many and on the other hand if he continues he would hit the man crossing the road. The rightness or wrongness of actions have gained importance rather than rightness or wrongness of the consequences of those actions.

Answer to Question No. 4(b)(ii)

Enlightened-egoism. This model takes into account harms, benefits and rights. Therefore, under this model an action is morally correct if it increases benefits for the individual in a way that does not intentionally hurt others, and if these benefits are believed to counterbalance any unintentional harms that ensue. In the present case company provides with all benefits to employees concerned with educational facilities alongwith leaves, fees etc. but ultimately company's self interest comes into play, employees are required to sign a bond to continue for five years or refund the expenses incurred by the organization.

Question No. 5

(a) Discuss about the development of successful sustainability report and the benefits of sustainability reporting. (8 marks)

(b) Organizations should set its goal towards creation of absolute value to the society. Explain the statement elaborating on the key aspects that a company should focus as a good corporate citizen. (8 marks)

Answer to Question No. 5(a)

The term sustainability accounting is used to describe the new information management and accounting methods that aim to create and provide high quality information to support a corporation in its movement towards sustainability. Sustainability reporting describes new formalized means of communication which provides information about corporate sustainability.

The Sustainability Reporting Guidelines developed by the Global Reporting Initiative (GRI), the Netherlands, is a significant system that integrates sustainability issues in to a frame of reporting. "Sustainability reporting is the practice of measuring, disclosing, and being accountable to internal and external stakeholders for organizational performance towards the goal of sustainable development".

A sustainability report should provide a balanced and reasonable representation of the sustainability performance of a reporting organization – including both positive and negative contributions".

Corporate sustainability reports are usually developed either by employees from the environment or sustainability department or from corporate communications unit or by external agency.

Reporting activity should be embedded in the general communication concept. Developing successful sustainability will require a well managed team based process involving different departments or external communication agencies. Efforts should be focused on the systematization and consolidation of experiences which improve the knowledge.

Benefits of successful reporting are as follows

- Legitimation of corporate activities, products and services which create environmental and social impacts.
- Increase in corporate reputation and brand value.
- Gaining a competitive advantage.
- Comparison and benchmarking against competitors.
- Increasing transparency and accountability within the company.
- Establishing and supporting employee motivation as well as internal information and control processes.

Answer to Question No. 5(b)

Organisations should set its goal towards creation of absolute value to the society. As a good corporate citizen, the companies are required to focus on the following key aspects:

Ethical Corporate Practices

By following non-ethical practices a business can never attain sustainability in long run. Society denies accepting such products or services which adversely impact the society.In long run such business would never succeed.

Worth of Earth through Environmental Protection

Resources which are not ubiquitous and have economic and social value should be preserved for long term use and be priced properly after considering environmental and social costs.

Equitable Business Practices

Corporates should not divulge themselves in unfair means and it should create candid business practices, ensure healthy competition and fair trade practices.

Corporate Social Responsibility

Every corporate is duty bound to its society wherein they operate and serve. For this purpose CSR activities need to be clubbed and integrated into the business model of the Company.

Innovate new technology/process/system to achieve eco-efficiency

Innovation is the key to success. Risks and crisis can be eliminated through innovation. The innovative processes bring sustainability if developments are aimed at satisfying human needs and brings quality of life, while progressively reducing ecological impact and resource intensity to a level at least in line with earth's estimated carrying capacity.

Creating Market for All

A corporate is to build up its products and services in such a way so as to cater all segments of customers/consumers. Customers confidence is essence to corporate success.

Switching over from Stakeholders Dialogue to holistic Partnership

It is important to build confidence of various stakeholders, and it also helps the management to steer the business under a very dynamic and flexible system. This approach offers business, government and other stakeholders of the society to build up alliance towards bringing common solutions to common concerns.

Compliance of Statutes

Compliance of statutes, rules and regulations, standards set by various bodies ensures a check on the functioning of a corporate and confers societal license to the corporate to run and operate in the society.

Question No. 6

(a) Describe in detail about the Communication of Progress under the UN Global Compact. (8 marks)

(b) Discuss in detail about Kyoto Protocol and Bali roadmap. (8 marks)

Answer to Question No. 6(a)

Communications on Progress (COP) is a report to inform the company's stakeholders about the company's progress in implementing the Global Compact's ten principles. The

purpose of the COP is both to ensure and deepen the commitment of Global Compact participants and to safeguard the integrity of the initiative.

The UN Global Compact presents a unique and powerful platform for participants to advance their commitments to sustainability and corporate citizenship. COPs should be integrated into a participant's existing communication with stakeholders, such as an annual or sustainability report. However, in case a participant does not publish such reports, a COP can be a stand-alone report that is made available for stakeholders through other public communication channels. Participants are asked to supply a URL link to their COP and to upload the COP itself to the Global Compact website in order to meet the COP submission requirement.

While there is no strict format for a COP, in order to be considered complete, it must contain:

— a statement of continued support for the Global Compact in the opening letter, statement or message from the company's top executive;

— description of practical actions that participants have taken to implement the Global Compact principles since their last COP (or since they joined the Global Compact);

— a measurement of outcomes or expected outcomes using, as much as possible, indicators or metrics such as, for example, the Global Reporting Initiative Guidelines.

Initial COP submission - Company participants are required to submit a first COP within two years from the date of joining the Global Compact. If a company fails to meet this initial submission deadline, it will be marked as non-communicating in the participant database of the Global Compact website. Further, if a company also misses the second COP deadline after an additional year, the company will be removed from the Global Compact database of active participants and listed as inactive on the Global Compact website.

Subsequent COP submissions - All subsequent COPs are due within one year following the previous COP submission. If a company fails to meet this submission deadline, it will be marked as non-communicating on the Global Compact website. Further, if a company fails to submit a COP within two years of their previous submission, the company will be removed from the Global Compact database of active participants and listed as inactive on the Global Compact website.

Grace period - A 45-90 day grace period between the COP due date and the status change (from active to non-communicating or from non-communicating to inactive) can be granted to those companies that contact the Global Compact Office and provide a reasonable explanation for the delay in communication.

Answer to Question No. 6(b)

Kyoto Protocol

The Kyoto Protocol, adopted at the third Conference of the Parties to the UNFCCC (COP 3) in Kyoto, Japan, in 1997 came into force in 2005, is an international agreement linked to the United Nations Framework Convention on Climate Change. The major

feature of the Kyoto Protocol is that it sets binding targets for 37 industrialized countries and the European community for reducing greenhouse gas emissions. The major distinction between the Protocol and the Convention is that while the Convention encouraged industrialised countries to stabilize GHG emissions, the Protocol commits them to do so.

The Protocol requires developed countries to reduce their GHG emissions below levels specified for each of them in the Treaty. These targets must be met within a five-year time frame between 2008 and 2012. The Protocol places a heavier burden on developed nations under the principle of "common but differentiated responsibilities." This has two main reasons. Firstly, those countries can more easily pay the cost of cutting emissions. Secondly, developed countries have historically contributed more to the problem by emitting larger amounts of GHGs per person than in developing countries.

In order to give Parties a certain degree of flexibility in meeting their emission reduction targets, the Protocol developed three innovative mechanisms - known as Emissions Trading (the carbon market), Joint Implementation and the Clean Development Mechanism (CDM).

These market-based mechanisms allow developed Parties to earn and trade emissions credits through projects implemented either in other developed countries or in developing countries, which they can use towards meeting their commitments. These mechanisms help identify lowest-cost opportunities for reducing emissions and attract private sector participation in emission reduction efforts. The Kyoto Protocol is generally seen as an important first step towards a truly global emission reduction regime that will stabilize GHG concentrations at a level which will avoid dangerous climate change. The first commitment period of the Kyoto Protocol expires in 2012.

Bali Roadmap

At the 2007 United Nations Climate Change Conference in Bali, Indonesia in December, 2007, the participating nations adopted the Bali Roadmap as a two-year process to finalizing a binding agreement in 2009 in Denmark.

The Bali Road Map consists of a number of forward-looking decisions that represent the various tracks, essential to reaching a secure climate future. The Bali Road Map includes the Bali Action Plan, which charts the course for a new negotiating process designed to tackle climate change, with the aim of completing this by 2009. To conduct the process, a subsidiary body under the Convention was set up, called the Ad Hoc Working Group on Long-term Cooperative Action under the Convention (AWG-LCA).

Question No. 7

Discuss in detail about the outcomes of the Earth Summit. *(16 marks)*

Answer to Question No. 7

The United Nations Commission on Sustainable Development (CSD) was established by the UN General Assembly in December 1992 to ensure effective follow-up of United Nations Conference on Environment and Development (UNCED) (known as the Earth

Summit) held in Rio De Janeiro. The following documents were the result of the Rio Summit :

Agenda 21 – is a blueprint on how to make development socially, economically and environmentally sustainable. It is a guide for individuals, businesses and governments in making choices for development that help society and the environment. Agenda 21 deals with

1. Social and economic dimensions
2. Conservation and management of resources
3. Strengthening the role of major groups, including women; children and youth; indigenous peoples; non-governmental organizations local authorities; workers; business and industry; farmers; scientists and technologists.
4. Means of implementation by way of finance; technology transfer; science; education; capacity-building; international institutions; legal measures; information.

The Rio Declaration on Environment and Development – it has 27 principles defining the rights and responsibilities of nations as they pursue human development and well-being.The main intention being guidance for future sustainable development around the world.

A statement of forest principles – It is a non-Legally Binding Authoritative Statement of Principles for a Global Consensus on the Management, Conservation and Sustainable Development of all types of Forests. The guiding objective of these principles is to contribute to the management, conservation and sustainable development of forests and to provide for their multiple and complementary functions and uses.

The United Nations Framework Convention on Climate Change – It is an international environmental treaty produced at the United Nations Conference on Environment and Development (UNCED). The treaty is aimed at stabilizing greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic (due to human activity) interference with the climate system.

The Convention on Biological Diversity – is an international treaty that was adopted in Rio de Janeiro in June 1992. The Convention has three main goals:

1. conservation of biological diversity;
2. sustainable use of its components; and
3. fair and equitable sharing of benefits arising from genetic resources.

TEST PAPER 3/2010

(This Test Paper is based on Entire Study Material)

Time allowed : 3 hours *Max. marks : 100*

PART A

(Attempt any THREE questions including Question No. 1 which is COMPULSORY)

Question No. 1

(a) Fill in the blanks :

(i) The first corporate governance code developed in United Kingdom was_________.

(ii) In terms of Cause 49 the Audit Committee should comprise of________.

(iii) Where a company wishes to offer its shares under ESOP/ESP Scheme, a company has to constitute________ committee.

(iv) In internal control framework ____________ are the policies and procedures that ensures that management directives are carried out.

(v) The Chief Executive is responsible for the running of the company's business whereas the _______________ is responsible for the running of the board.

(1 mark each)

(b) State whether the following statements are true or false :

(i) Insurance is a method of risk avoidance.

(ii) The New York Stock Exchange Listing Rules adopts "comply" or "explain" approach.

(iii) The shareholders grievance committee should be constituted under the chairmanship of an executive director.

(iv) Training of directors is a mandatory requirement under Clause 49 of the Listing Agreement.

(v) In terms of Clause 49, related party transactions are prohibited.

(1 mark each)

(c) Choose the most appropriate answer :

(i) Compulsory audit partner rotation was recommended by which of the following committees :

(a) Naresh Chandra Committee

(b) Kumar Mangalam Birla Committee

(c) Naryana Murthy Committee

(d) J J Irani Committee.

(ii) In terms of Clause 49, which of the following is a mandatory requirement:

(a) Whistle Blower Policy

(b) Performance Evaluation of Board

(c) Training of directors

(d) Code of Conduct for directors

(iii) Which of the following is a non-mandatory requirement in terms of Clause 49 :

(a) Whi stle blower policy

(b) Disclosure of related party transaction

(c) Constitution of Audit Committee

(d) Laying down of code of conduct for directors and senior members.

(iv) Clause 41 of the listing agreement mandates disclosure of financial results on :

(a) Monthly basis

(b) Quarterly basis

(c) Half-yearly basis

(d) Annual basis.

(v) In terms of Regulation 8(3) of SEBI (Substantial Acquisition & Takeover) Regulations, a company shall make disclosure to Stock Exchanges which the shares of the company are listed, the changes in the holding of acquirer/promoter.

(a) Within 30 days from the financial year ending March 31 as well as record date of the company for the purpose of declaration of dividend.

(b) Within 30 days from the financial year ending March 31.

(c) Within 30 days from the financial year ending of the company.

(d) Within 15 days from the year ending December 31. (1 mark each)

Answer to Question No. 1(a)

(i) The first corporate governance code developed in United Kingdom was **Cadbury Committee Report 1992** .

(ii) In terms of Cause 49 the Audit Committee should comprise of **minimum 3 directors** .

(iii) Where a company wishes to offer its shares under ESOP/ESP Scheme, a company has to constitute **compensation** committee.

(iv) In internal control framework **control activities** are the policies and procedures that ensures that management directives are carried out.

(v) The Chief Executive is responsible for the running of the company's business whereas the **Chairman** is responsible for the running of the board.

Answer to Question No. 1(b)(i)

False.

Insurance is not a method of risk avoidance but it is a method of risk transfer. In this the risk is transferred to an organization that specializes in accepting risk at a price.

Answer to Question No. 1(b)(ii)

False.

Companies listed on New York Stock Exchange are required to comply with certain standards.

Answer to Question No. 1(b)(iii)

False.

Clause 49-IV(G)(iii) of the listing agreement shareholder Committee shall be formed under the chairmanship of a non-executive director.

Answer to Question No. 1(b)(iv)

False.

Under Clause 49 training of the directors is not a mandatory requirement.

Answer to Question No. 1(b)(v)

False.

Clause 49 does not prohibit related party transactions rather it provides for disclosures at different level of transaction.

Answer to Question No. 1(c)(i)

(a) Naresh Chandra Committee

Answer to Question No. 1(c)(ii)

(d) Code of Conduct of directors

Answer to Question No. 1(c)(iii)

(a) Whistle Blower Policy

Answer to Question No. 1(c)(iv)

(b) Quarterly basis

Answer to Question No. 1(c)(v)

(b) Within 30 days from the financial year ending March 31.

Question No. 2

(a) Write a brief note on the matters that shall be mandatorily reviewed by the audit committee. *(5 marks)*

(b) Write a note on the criteria of independence of a director and concept of senior independent director in terms of U K Combined Code. (10 marks)

Answer to Question No. 2(a)

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.

Answer to Question No. 2(b)

The U.K combined code on corporate governance applies to listed companies who shall report on the 'comply or explain basis'. In the terms of the Combined Code, the Board is required to determine whether a director is independent or not. For the determination of director's independence following are the factors relevant for considering the independence of director:

(a) has been an employee of the company or group within the last five years;

(b) has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;

(c) has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;

(d) has close family ties with any of the company's advisers, directors or senior employees;

(e) holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;

(f) represents a significant shareholder; or

(g) has served on the board for more than nine years from the date of their first election.

The code requires the board to appoint one of the independent non-executive directors to be the senior independent director. The senior independent director should be available to shareholders if they have concerns which have remained unresolved in spite of taking up with chairman, chief executive or finance director.

Question No. 3

(a) *Examine the role of the Board of Directors in internal control.* *(10 marks)*

(b) *Describe the provisions on risk management under the Listing Agreement.* *(5 marks)*

Answer to Question No. 3(a)

Board of Directors

The board of directors is responsible for the company's system of internal control. It should set appropriate policies on internal control and seek regular assurance that will enable it to satisfy itself that the system is functioning effectively. The board must further ensure that the system of internal control is effective in managing those risks in the manner which it has approved.

The board's deliberations should include consideration of the following factors:

— the nature and extent of the risks facing the company;

— the extent and categories of risk which it regards as acceptable for the company to bear;

— the likelihood of the risks concerned materialising;

— the company's ability to reduce the incidence and impact on the business of risks that do materialise; and

— the costs of operating particular controls relative to the benefit thereby obtained in managing the related risks.

Reviewing the effectiveness of internal control is an essential part of the board's responsibilities. The board will need to form its own view on effectiveness based on the information and assurances provided to it, exercising the standard of care generally applicable to directors in the exercise of their duties.

Effective monitoring on a continuous basis is an essential component of a sound system of internal control. the board should undertake an annual assessment for the purposes of making its public statement in the Management Discussion and Analysis Report on internal control to ensure that it has considered all significant aspects of internal control for the company for the year under review and up to the date of approval of the annual report and accounts.

The board should define the process to be adopted for its review of the effectiveness of internal control. This should encompass both the scope and frequency of the reports it receives and reviews during the year, and also the process for its annual assessment, such that it will be provided with sound, appropriately documented, support for its statement on internal control in the company's annual report and accounts.

The board's annual assessment should, in particular, consider:

— the changes since the last annual assessment in the nature and extent of significant risks, and the company's ability to respond to changes in its business and the external environment;

— the scope and quality of management's ongoing monitoring of risks and of the system of internal control, and, where applicable, the work of its internal audit function and other providers of assurance;

— the incidence of significant control failings or weaknesses that have been identified at any time during the period and the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the company's financial performance or condition; and the effectiveness of the company's public reporting processes.

Answer to Question No. 3(b)

Legal Provisions on Risk Management under the Listing Agreement

In terms of Clause 49 of the Listing Agreement

— 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.

— Management Discussion & Analysis should include discussion on

1. Risks and concerns.
2. Internal control systems and their adequacy.

Question No. 4

Discuss in detail about the recommendations of the Institutional Shareholders' Committee for institutional investors. *(15 marks)*

Answer to Question No. 4

The Institutional Shareholders' Committee (ISC) whose members comprise the Association of British Insurers (ABI), the National Association of Pension Funds (NAPF), the Association of Investment Companies (AIC), and the Investment Management Association (IMA), has made the following recommendations for institutional investors on the policy of activism, monitoring the performance and intervening mechanism:

(i) *Policy document on activism*

The policy would be a public document and would address the following areas:

— how investee companies will be monitored;

— the policy for requiring investee companies' compliance with the Combined Code;

— the policy for meeting with an investee company's board and senior management;

— how any conflicts of interest will be dealt with;

— the strategy on intervention;

— indication of when and how further action may be taken and

— policy on voting.

(ii) *Institutional investors should monitor performance*

The Monitoring performance should be a regular process, clearly communicable and checked periodically for its effectiveness. It would include reviewing annual reports and accounts, circulars and resolutions; and attending company meetings. institutional shareholders should try to satisfy themselves that the

— Investee company's board and sub-committee structures are effective;

— Independent directors provide adequate oversight and maintain a clear audit trail of their meetings and of votes cast on company resolutions.

(iii) *Institutional investors intervene when necessary*

Institutional investors intervene when necessary and such intervention may occur when they have concerns about a range of issues including the company's strategy; its operational performance; its acquisition/disposal strategy; independent directors failing to hold executive management properly to account; internal controls failure; inadequate succession planning; an unjustifiable failure to comply with the Combined Code; inappropriate remuneration packages; and the company's approach to corporate social responsibility.

Boards should be given the chance to respond constructively but if they do not, then the institutional investors may choose to escalate their action through a range of ways including intervening jointly with other institutions on particular issues.Finally, institutional investors should evaluate and report on the outcomes of their shareholder activism.

PART B

Question No. 5

(a) Fill in the blanks :

(i) An_____________ helps a company minimize the risk of misconduct and wrong doing by employees.

(ii) The Japanese concept_____________________ means living and working together for the common good enabling co-operation and mutual prosperity to co-exist with healthy and fair competition.

(iii) Section 406 of Sarbanes Oxley Act, 2002 requires public companies to disclose whether they have_________

(iv) The first step in conducting an ethics audit is securing the commitment of the firm's________

(v) __________ stakeholders do not normally engage in transaction with the company and are not essential for its survival.

(vi) A ___________________ organization is very bureaucratic and employees may behave according to the letter of law rather than spirit. (1 mark each)

(b) List out the six core values that are desirable for code of ethics. (4 marks)

Answer to Question No. 5(a)

(i) An **ethics programme** helps a company minimize the risk of misconduct and wrong doing by employees.

(ii) The Japanese concept **kyosei** means living and working together for the common good enabling co-operation and mutual prosperity to co-exist with healthy and fair competition.

(iii) Section 406 of Sarbanes Oxley Act, 2002 requires public companies to disclose whether they have **code of ethics** .

(iv) The first step in conducting an ethics audit is securing the commitment of the firm's **top management** .

(v) **Secondary** stakeholders do not normally engage in transaction with the company and are not essential for its survival.

(vi) A **centralized** organization is very bureaucratic and employees may behave according to the letter of law rather than spirit.

Answer to Question No. 5(b)

A **code of ethics** is the most comprehensive and consists of general statements, sometimes altruistic or inspirational, that serve as principles and the basis for rules of conduct. A code of ethics generally specifies methods for reporting violations, disciplinary action for violations, and a structure of due process.

Corporate codes of ethics often contain about six core values or principles in addition to more detailed descriptions and examples of appropriate conduct. The six values that are desirable for codes of ethics include: (1) trustworthiness, (2) respect, (3) responsibility, (4) fairness, (5) caring, and (6) citizenship.

Question No. 6

(a) Deliberate on the role of leadership in the ethical framework of a firm. *(5 marks)*

(b) Describe the steps suggested to conduct an ethics audit. *(5 marks)*

(c) Written standards deter wrong doing and promote ethical behaviour. Elucidate the statement. *(5 marks)*

(d) Describe the stakeholder principle with regard to suppliers in terms of Caux Round Table. *(5 marks)*

Answer to Question No. 6(a)

Leadership, the ability or authority to guide and direct others towards achievement of a goal, has a significant impact on ethical decision making because leaders have the power to motivate and others and enforce organization's rules and policies. Leaders are the key to influencing organisation's corporate culture and ethical climate. If the leaders fail to express desired behaviours and goals, a corporate culture will evolve on its own which may not reflect the goals and values of the company. An effective leader is required to balance profit-motivated entrepreneurial skills and corporate citizenship. It

entails translating the personal energy and vision of an outstanding entrepreneur into the corporate energy of an enduring company.

Enduring leadership i.e. leadership that outlasts and transcends the individual ensures the long-term success of an organization.

Leaders have two jobs. One is to stimulate and drive the organization they lead so that it survives, prospers and achieves its goals. The other is to create the climate, the culture and the conditions that enable people, in the present and in the future, to contribute effectively to that performance.

Answer to Question No. 6(b)

The following are the some of the suggested steps in ethics audit :

1. The first step in conducting an audit is securing the commitment of the firm's top management.
2. The second step is establishing a committee or team to oversee the audit process.
3. The third step is establishing the scope of the audit.
4. The fourth step should include a review of the firm's mission values, goals, and policies.
5. The fifth step is identifying the tools or methods that can be employed to measure the firm's progress and then collecting and analyzing the relevant information.
6. The sixth step is having the results of the data analysis verified by an independent party.
7. The final step in the audit process is reporting the audit findings to the board of directors and top executives and, if approved, to external stakeholders.

Answer to Question No. 6(c)

Written ethical standards deter wrong doing and promote the following:

1. Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
2. Full, fair, accurate, timely, and understandable disclosure in reports and documents that a company files with, or submits to, the Commission and in other public communications made by the [company];
3. Compliance with applicable governmental laws, rules and regulations;
4. The prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and,
5. Accountability for adherence to the code.

With written ethical standards it is easy for the to educate employees about ethical framework and analyzing business ethics.

Answer to Question No. 6(d)

Suppliers

In terms of the Caux Round Table Stakeholder Principles, the relationship with suppliers and subcontractors must be based on mutual respect. Therefore there is a responsibility to :

— seek fairness and truthfulness in all activities, including pricing, licensing, and rights to sell;

— ensure that business activities are free from coercion and unnecessary litigation;

— foster long-term stability in the supplier relationship in return for value, quality, competitiveness and reliability;

— share information with suppliers and integrate them into planning processes;

— pay suppliers on time and in accordance with agreed terms of trade; and

— seek, encourage and prefer suppliers and subcontractors whose employment practices respect human dignity.

PART C

Question No. 7

(a) Fill in the blanks :

(i) The Earth Summit in Rio resulted in a blue print on how to make development socially, economically and environmentally sustainable and is termed as_________ .

(ii) Under the UN Global Compact, a failure to submit a communication of progress, within_______ of its previous submission, the company will be removed from the database of active participants.

(iii) _____________ tracks the environmental impacts of a product from its new material through disposal at the end of its useful life.

(iv) The United Nations framework convention on climate change aims to__________ .

(v) Absolute liability for escape of impounded water was first estimated in English in the case of ________________ .

(vi) The three elements of GRI sustainability Reporting Guidelines are________.
(1 mark each)

(b) Describe the concept of materiality under the Global Reporting Initiative.
(5 marks)

(c) Indicate the documents that are analysed under the Dow Jones Sustainability Index. (5 marks)

(d) Describe briefly about the International Forest Carbon Initiative. (4 marks)

Answer to Question No. 7(a)

(i) The Earth Summit in Rio resulted in a blue print on how to make development socially, economically and environmentally sustainable and is termed as **agenda-21** .

(ii) Under the UN Global Compact, a failure to submit a communication of progress, within **1 year** of its previous submission, the company will be removed from the database of active participants.

(iii) **Life Cycle Assessment** tracks the environmental impacts of a product from its new material through disposal at the end of its useful life.

(iv) The United Nations framework convention on climate change aims to **stabilize Green house Gas concentration** .

(v) Absolute liability for escape of impounded water was first estimated in English in the case of **Rylands V. Fletcher** .

(vi) The three elements of GRI sustainability Reporting Guidelines are **reporting principle, reporting guidance & standard disclosure** .

Answer to Question No. 7(b)

Materiality is the threshold at which an issue or indicator becomes sufficiently important that it should be reported. Materiality for sustainability reporting is not limited only to those sustainability topics that have s significant financial impact on the organization. It also includes considering economic, environmental and social impacts that cross a threshold in affecting the ability to meet the needs of the present without compromising the needs of future generations.

"A combination of internal and external factors should be used to determine whether information is material, including factors such as the organisation's overall mission and competitive strategy, concerns expressed directly by stakeholders and the organisation's influence on upstream (e.g. customers) entities. Assessments of materiality should also take into account the basic expectations expressed in the international standards and agreements":

Answer to Question No. 7(c)

The Dow Jones Sustainability Indices are the first global indices tracking the financial performance of the leading sustainability-driven companies worldwide.The Dow Jones Sustainability World Index (DJSI World) comprises more than 300 companies that represent the top 10% of the leading sustainability companies out of the biggest 2500 companies in the Dow Jones World Index.

Documents analyzed under Dow Jones Sustainability Index include:

— Sustainability reports

— Environmental reports

— Health and safety reports

— Social reports

— Annual financial reports

— Special reports (e.g. on intellectual capital management, corporate governance, R&D, employee relations)

— All other sources of company information; e.g. internal documentation, brochures and website.

Answer to Question No. 7(d)

International Forest Carbon Initiative

The International Forest Carbon Initiative is a key part of Australia's international leadership on reducing emissions from deforestation. The Initiative will support international efforts to reduce deforestation through the United Nations Framework Convention on Climate Change (UNFCCC). It aims to demonstrate that reducing emissions from deforestation and forest degradation can be part of an equitable and effective international agreement on climate change. A central element is the Initiative's focus on developing practical demonstration activities, particularly in Indonesia and Papua New Guinea.

TEST PAPER 4/2010

(This Test Paper is based on Entire Study Material)

Time allowed : 3 hours *Max. marks : 100*

PART A

(Attempt any THREE questions including Question No. 1 which is COMPULSORY)

Question No. 1

(a) Fill in the blanks with appropriate words :

(i) As per Clause 49 of the Listing Agreement, an independent director should not be less than ______ years of age.

(ii) In Arthashastra __________ literally means protection, in the corporate scenario it can be equated with the risk management aspect.

(iii) __________________ are expected to bring a valuable outside perspective to the deliberations in the board.

(iv) It is the role of ___________ to carry through the strategy on behalf of the directors.

(v) In terms of Clause 35, a company is required to file shareholding pattern within_____________. *(1 mark each)*

(b) State whether the following are true or false :

(i) In terms of Clause 49 of the Listing Agreement, it is mandatory to constitute a remuneration committee.

(ii) As per Sec. 292A of the Companies Act, 1956, every public company shall constitute a Committee of the Board to be known as Audit Committee.

(iii) Section 275 of the Companies Act, 1956 stipulates that a person cannot hold office at the same time as a Director in more than fifteen companies.

(iv) Clause 49 of the Listing Agreement obligates a company to make disclosure about the remuneration of directors.

(v) Internal Control plays an important role in preventing and detecting fraud and protecting the organization's resources. *(1 mark each)*

(c) Choose the most appropriate answer :

(i) The people issues faced by the organization under the Triple Bottom Line approach include :

(a) Climate change

(b) Water management

(c) Education and literacy

(d) Waste management

(ii) As per Clause 41 of the Listing Agreement notice of Board Meeting should be given to the Stock Exchange :

(a) No notice is required to be given.

(b) At least 7 days in advance.

(c) At least 14 days in advance.

(d) At least 2 days in advance.

(iii) Sarbanes Oxley Act does not ban the which of the following service by Statutory Auditor:

(a) Financial information systems design and implementation.

(b) Actuarial services;

(c) Management functions or human resources;

(d) Tax Services

(iv) The Ministry of Corporate Affairs, Government of India, has set up National Foundation for Corporate Governance (NFCG) in partnership with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and

(a) Indian Institutes of Management (IIM)

(b) Associated Chambers of Commerce and Industry of India (ASSOCHAM)

(c) Institute of Chartered Accountants of India (ICAI)

(d) Institute of Cost and Works Accountant of India (ICWAI)

(v) Which of the following is a mandatory committee under Clause 49 of the Listing Agreement?

(a) Shareholders Grievance Committee

(b) Risk Management Committee

(c) Remuneration Committee

(d) Nomination Committee (1 mark each)

(d) Discuss in brief about the 'comply or explain' approach under the Combined Code. (5 marks)

Answer to Question No. 1(a)

(i) As per Clause 49 of the Listing Agreement, an independent director should not be less than **21** years of age.

(ii) In Arthashastra **Raksha** literally means protection, in the corporate scenario it can be equated with the risk management aspect.

(iii) **Independent directors** are expected to bring a valuable outside perspective to the deliberations in the board.

(iv) It is the role of **top management** to carry through the strategy on behalf of the directors.

(v) In terms of Clause 35, a company is required to file shareholding pattern within **21 days from the end of each quarter**.

Answer to Question No. 1(b)(i)

False

It is non- mandatory requirement.

Answer to Question No. 1(b)(ii)

False

Every public company having a paid up capital of 5 cr. or more is required to constitute a committee known as Audit Committee.

Answer to Question No. 1(b)(iii)

True

A person can act as a director in maximum15 companies at a time.

Answer to Question No. 1(b)(iv)

True

As per clause 49-I (B), all fees, compensation, if any, paid to non-executive directors including independent directors shall be disclosed to shareholders.

Answer to Question No. 1(b)(v)

True

An effective internal control contribute to the safeguarding of assets, including the prevention and detection of fraud.

Answer to Question No. 1(c)(i)

(c) Education and literacy.

Answer to Question No. 1(c)(ii)

(b) At least 7 days in advance.

Answer to Question No. 1(c)(iii)

(d) Tax services

Answer to Question No. 1(c)(iv)

(c) Institute of Chartered Accountants of India (ICAI)

Answer to Question No. 1(c)(v)

(a) Shareholders Grievance Committee.

Answer to Question No. 1(d)

The Combined Code is voluntary. However, the Listing Rules require UK incorporated

listed companies, in their annual accounts, to (i) report on how they apply its main principles and (ii) either confirm that they comply with its detailed provisions or explain their non-compliance (known as the "comply or explain" basis). The strength of the Combined Code is considered to be that whilst voluntary and so flexible, it represents best practice and most companies will endeavour to comply with it, so that they do not have to explain non-compliance publicly.

Corporate governance regulation and practice is deeply-routed in the UK. There has been a Combined Code against which listed companies have to report, on the comply or explain basis, since 1998. Key aspects of corporate governance in the UK are:

— a single board with checks and balances;
— effective rights for shareholders;
— transparency; and
— a best practice code on corporate governance, operating on a comply or explain basis.

Question No. 2

(a) Briefly discuss the key difference between directors and managers. *(8 marks)*

(b) Describe the duties and responsibilities that can be delegated to Corporate Governance Committee. *(7 marks)*

Answer to Question No. 2(a)

The following are the key differences between directors and managers:

	Directors	*Managers*
Leadership	It is the board of directors who must provide the intrinsic leadership and direction at the top of the organization.	It is the role of managers to carry through the strategy on behalf of the directors.
Decision Making	Directors are required to determine the future of the organization and protect its assets and reputation. They also need to consider how their decisions related to 'Stakeholders' and the regulatory framework.	Managers are concerned with implementing the decisions and the policies made by the board.
Duties and responsibilities	Directors, not managers, have the ultimate responsibility for the longer - term prosperity of the company. Directors are required in law to apply skill and care in exercising their duty to the company and are subject to fiduciary duties. If they are in breach of their duties or act improperly directors may be	Managers have far fewer legal responsibilities.

	Directors	*Managers*
	made personally liable in both civil and criminal law. On occasion, directors can be held responsible for acts of the company. Directors also owe certain duties to the stake-holders of the company.	
Relationship with share-holders	Directors are accountable to the shareholders for the company's performance and can be removed from office by them or the share-holders can pass a special resolution requiring the Directors to act in a particular way. Directors act as "Fiduciaries" of the shareholders and should act in their best interests but also taking into account the best interests of the company (as a separate legal entity) and the other stakeholders.	Managers are usually appointed and dismissed by directors or management and do not have any legal requirement to be held to account.
Ethics and values	Directors have a key role in the determination of the value and ethical position of the company.	Managers must enact the ethos, taking their direction from the board.
Company Adminis-tration	Directors are responsible for the company's administration.	While the related duties associated with company administration can be delegated to managers, the ultimate responsibility for them resides with the directors.
Statutory Provisions on insolvency	If a company becomes insolvent, law imposes various duties and responsibilities on directors that may involve personal liability, criminal prosecution and disqualification.	These statutory provisions do not affect managers.
Statutory Provisions in general	There are many other statutory provisions that can create offences on strict liability under which Directors may face penalties if the company fails to comply. A very wide range of statutes impose duties on Directors which are numerous.	Generally managers are not responsible under the Statutory Provisions.
Disqualifi-cation	Directors can be disqualified as Directors under law.	The control over the employment of a Manager rests with the company.

Answer to Question No. 2(b)

Corporate Governance Committee

A company may constitute this committee to develop and recommend the board a set of corporate governance guidelines applicable to the company, implement policies and processes relating to corporate governance principles, to review, periodically, the corporate governance guidelines of the company. Many companies give the mandate of corporate governance to nomination committee and is given the nomenclature Nomination and Corporate Governance Committee.

The committee is responsible for considering matters relating to corporate governance including the composition of board, appointment of new directors, review of strategic human resource decisions, succession planning for the chairman and other key board and executive positions, performance evaluation of the board and its committees and individual directors.

Question No. 3

Explain the regulatory framework as contained in the Combined Code for Companies listed on the Main Market of the London Stock Exchange. *(15 marks)*

Answer to Question No. 3

The Combined Code on corporate Governance sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders. The listed companies in this code have to report, on the comply or explain basis, since 1998. Key aspects of corporate governance in the UK are:

— a single board with checks and balances;

— effective rights for shareholders;

— transparency; and

— a best practice code on corporate governance, operating on a comply or explain basis.

The Combined Code is voluntary. However, the Listing Rules require UK incorporated listed companies, in their annual accounts, to (i) report on how they apply its main principles and (ii) either confirm that they comply with its detailed provisions or explain their non-compliance (known as the “comply or explain” basis). The strength of the Combined Code is considered to be that whilst voluntary and so flexible, it represents best practice and most companies will endeavour to comply with it, so that they do not have to explain non-compliance publicly.

As regards all UK limited companies, the primary corporate legislation is contained within the Companies Act 2006 (the “2006 Act”) and the Companies Act 1985 (the “1985 Act”) (together the “Companies Acts”).

Listed companies must adhere to a number of additional rules and regulations, including various rules of the independent body that regulates the financial services industry in the UK, the Financial Services Authority (the “FSA”), as well as further best practice codes and guidance issued by others.

The Listing Rules require UK companies listed on the Main Market of the London Stock Exchange to explain in the annual report and accounts their corporate governance from two points of view, the first dealing generally with their adherence to the Code's main principles, and the second dealing specifically with non-compliance with any of the Code's provisions.

Companies and shareholders have a shared responsibility for ensuring that 'comply or explain' remains an effective alternative to a rules-based system. Satisfactory commitment between company boards and investors is therefore crucial to the health of the UK's corporate governance regime.

Question No. 4

(a) *Differentiate between Corporate Social Responsibility and philanthropy. Describe in detail the factors influencing CSR.* *(8 marks)*

(b) *What are the objectives of corporate governance ?* *(7 marks)*

Answer to Question No. 4(a)

Corporate Social Responsibilty is a commitment to improve community well-being through voluntary business practices and contribution of corporate resources leading to sustainable growth. It is not business activity mandated by law or moral or ethical in nature but expected of the corporates. Corporate responsibility is achieved when a business adapts all of its practices to ensure that it operates in ways that meet, or exceed, the ethical, legal, commercial and public expectations that society has of business.

The factors and influences which lead to increasing attention being devoted to CSR, include the following:

— Globalization – coupled with focus on cross-border trade, multinational enterprises and global supply chains — is increasingly raising CSR concerns related to human resource management practices, environmental protection, and health and safety, among other things.

— Governments and intergovernmental bodies, such as the United Nations, the Organisation for Economic Co-operation and Development and the International Labour Organization have developed compacts, declarations, guidelines, principles and other instruments that outline social norms for acceptable conduct.

— Advances in communications technology, such as the Internet, cellular phones and personal digital assistants, are making it easier to track corporate activities and disseminate information about them. Non-governmental organizations now regularly draw attention through their websites to business practices they view as problematic.

— Consumers and investors are showing increasing interest in supporting responsible business practices and are demanding more information on how companies are addressing risks and opportunities related to social and environmental issues.

— Numerous serious and high-profile breaches of corporate ethics have contributed

to elevated public mistrust of corporations and highlighted the need for improved corporate governance, transparency, accountability and ethical standards.

— Citizens in many countries are making it clear that corporations should meet standards of social and environmental care, no matter where they operate.

— There is increasing awareness of the limits of government legislative and regulatory initiatives to effectively capture all the issues that corporate social responsibility addresses.

— Businesses are recognizing that adopting an effective approach to CSR can reduce risk of business disruptions, open up new opportunities, and enhance brand and company reputation.

Philanthropy means the act of donating money, goods, time or effort to support a charitable cause in regard to a defined objective. Philanthropy can be equated with benevolence and charity for the poor and needy. Philanthropy can be any selfless giving towards any kind of social need that is not served, underserved, or perceived as unserved or underserved. Philanthropy can be by an individual or by a corporate.

Corporate Social Responsibilty is about how a company aligns their values to social causes by including and collaborating with their investors, suppliers, employees, regulators and the society as a whole. The investment in CSR may be on people centric issues and/ or planet issues. CSR initiatives of a corporate is not a selfless act of giving; companies derive long-term benefits from the CSR initiatives.

Answer to Question No. 4(b)

Good corporate Governance is integral to the sustainability of a company. It inspires strengthens investor's confidence by ensuring company's commitment to higher growth and profits. Following are the objectives of Corporate Governance:

(a) A properly structured Board capable of taking independent and objective decisions;

(b) Representation of non-executive and independent directors take care of interests and well being of the stakeholders;

(c) The board adopts transparent procedures and practices and arrives at decisions on the strength of adequate information;

(d) The Board has an effective machinery to sub serve the concerns of stakeholders;

(e) The Board keeps stakeholders informed about the relevant developments impacting the company;

(f) The Board effectively and regularly monitors the functioning of the management team;

(g) The Board remains in effective control of the affairs of the company at all times.

PART B

Question No. 5

(a) Fill in the blanks with appropriate words :

(i) The ethical tone of an organization is set at the ___________.

(ii) The dominant principle of social and ethical accounting is ____________.

(iii) The concerns of stakeholders are addressed at each stage of the process through regular involvement through________________.

(iv) ___________ stakeholders are defined as to whether they are affected by the firm and/or can potentially affect the firm.

(v) __________________ is a situation that requires a choice between options that are or seem equally unfavorable or mutually exclusive. (1 mark each)

(b) State with an example each as to what the following ethical philosophies mean:

(i) Relativism

(ii) Virtue Ethics (5 marks)

Answer to Question No. 5(a)

(i) The ethical tone of an organization is set at the **top** .

(ii) The dominant principle of social and ethical accounting is **inclusivity** .

(iii) The concerns of stakeholders are addressed at each stage of the process through regular involvement through **stakeholder engagement** .

(iv) **Descriptive** stakeholders are defined as to whether they are affected by the firm and/or can potentially affect the firm.

(v) **Ethical dilemma** is a situation that requires a choice between options that are or seem equally unfavorable or mutually exclusive.

Answer to Question No. 5(b)(i)

Relativism is the idea that some elements or aspects of experience or culture are relative to, i.e., dependent on, other elements or aspects. The term often refers to truth relativism, which is the doctrine that there are no absolute truths, i.e., that truth is always relative to some particular frame of reference, such as a language or a culture For example, killing animals for sport (like bull fightng) could be right for one culture and wrong in another culture.

Answer to Question No. 5(b)(ii)

Virtue Ethics theory is a branch of moral philosophy that emphasizes character, rather than rules or consequences, as the key element of ethical thinking. An example of this – when a person of good standing is found possessing a valuable article belonging to someone else it will be presumed that the article was loaned to him or kept with him for safe-keeping, whereas if it were in the possession of a person of doubtful or dubious character it would be presumed that he has stolen article.

Question No. 6

(a) Elucidate on the provisions that should be contained in Code of Conduct for board and management committee members ? (8 marks)

(b) Describe in detail the functions of an ethics committee. (12 marks)

Answer to Question No. 6(a)

The Model Code of Conduct of Board and management committee members shall include the following provisions:

As Board members

1. We undertake to inform the Chairman of the Board of any changes in our other board positions, relationship with other business and other events/ circumstances/ conditions that may interfere with our ability to perform Board/Board Committee duties or may impact the judgment of the Board as to whether we meet the independence requirements of Listing Agreement with Stock Exchanges.
2. We undertake that without prior approval of the disinterested members of the Board, we will avoid apparent conflict of interest. Conflict of interest may exist when we have personal interest that may have a potential conflict with the interest of the company at large.Cases can be:
   - — Related Party Transactions
   - — Outsiders Directorship
   - — Consultancy/ Business/ Employment
   - — Use of Official position for our personal gains.

Compliance with the Code

As employees of Company

The future of the organisation depends on both technical and ethical excellence. Not only is it important for employees to adhere to the principles expressed in this Code, each employee should encourage and support adherence by other employees.

Treat violations of this code as inconsistent association with the organisation

Adherence of professionals to a code of ethics is largely a voluntary matter. However, if any of us do not follow this code by engaging in process misconduct, the matter would be reviewed by the Board and its decision shall be final.

Miscellaneous

Continual updation of code

This code is subject to continuous review and updation in line with any changes in law, changes in company's philosophy, vision, business plans or otherwise as may be deemed necessary by the board.

Answer to Question No. 6(b)

The functions of the Ethics Committee of an organization involves the following areas:

Review of the definitions of standards and procedures

The Committee should review the organization's areas of operation, the activities that require a formal set of ethical standards and procedures. Once the review is complete

and any shortcomings have come to light the ethics committee should assign the creation of revised guidelines to the appropriate personnel including the design of a formal method for communicating standards and procedures to employees.

Facilitate Compliance

The ethics Committee has the responsibility for overall compliance. It is the responsible authority for ethics compliance within its area of jurisdiction It should serve as the court of last resort concerning interpretations of the organization's standards and procedures. The committee should make recommendations on improving the existing compliance mechanisms.

Due diligence of prospective employees

The ethics committee should define how the organization will balance the rights of individual applicants and employees against the organization's need to avoid risks that come from placing known violators in positions of discretionary responsibility.

Oversight of communication and training of ethics programme

The ethics committee should define methods and mechanisms for communicating ethical standards and procedures. This includes the distribution of documents (codes of conduct, for example) to ensure that every employee understands and accepts the organization's ethical guidelines.

Monitor and audit compliance

Compliance is an ongoing necessity and the ethics committee should design controls which monitor, audit and demonstrate employees' adherence to published standards and procedures. There should also be mechanisms which check the effectiveness and reliability of such internal controls.

Enforcement of disciplinary mechanism

Disciplinary provisions should be in place to ensure consistent responses to similar violations of standards and procedures. There should be provisions for those who ignore as well as those who violate standards and procedures.

Analysis and follow-up

When violations occur, the ethics committee should have ways to identify why they occurred. It is also important that lessons learned from prior violations are systematically applied to reduce the chance that similar violations takes place in future.

PART C

Question No. 7

(a) Fill in the blanks with appropriate words:

(i) ________________ tracks the environmental impacts of a product from its raw materials through disposal at the end of its useful life.

(ii) Company participants are required to submit a first Communication of Progress within _________ from the date of joining the UN Global Compact.

(iii) The World Commission on Environment and Development is popularly known as ____________________.

(iv) The Kyoto Protocol expires in ____________________.

(v) ______________________ enables reporting organizations to define the range of entities represented by the report under the Global Reporting Initiative.

(1 mark each)

(b) Discuss in brief about the Dow Jones Sustainability Index. (7 marks)

(c) Discuss with the help of a case law in India the departure from the Rylands Doctrine. (8 marks)

Answer to Question No. 7(a)

(i) **Life Cycle Assessment** tracks the environmental impacts of a product from its raw materials through disposal at the end of its useful life.

(ii) Company participants are required to submit a first Communication of Progress within **2 year** from the date of joining the UN Global Compact.

(iii) The World Commission on Environment and Development is popularly known as **Brundtland commission** .

(iv) The Kyoto Protocol expires in **2012** .

(v) **Reporting Boundary** enables reporting organizations to define the range of entities represented by the report under the Global Reporting Initiative.

Answer to Question No. 7(b)

The Dow Jones Sustainability Indices are the first global indices tracking the financial performance of the leading sustainability-driven companies worldwide, it was launched in 1999.

The Dow Jones Sustainability World Index (DJSI World) comprises more than 300 companies that represent the top 10% of the leading sustainability companies out of the biggest 2500 companies in the Dow Jones World Index.

Corporate Sustainability Assessment Criteria under the Dow-Jones Indices is as under:

Dimension	*Criteria*	*Weighting (%)*
Economic	Codes of Conduct / Compliance / Corruption & Bribery	5.5
	Corporate Governance	6.0
	Risk & Crisis Management	6.0
	Industry Specific Criteria	Depends on Industry
Environment	Environmental Performance Eco-Efficiency)	7.0
	Environmental Reporting*	3.0
	Industry Specific Criteria	Depends on Industry

Dimension	*Criteria*	*Weighting (%)*
Social	Corporate Citizenship/ Philanthropy	3.5
	Labor Practice Indicators	5.0
	Human Capital Development5.	5
	Social Reporting*	3.0
	Talent Attraction & Retention	5.5
	Industry Specific Criteria	Depends on Industry

Documents analyzed include:

— Sustainability reports

— Environmental reports

— Health and safety reports

— Social reports

— Annual financial reports

— Special reports (e.g. on intellectual capital management, corporate governance, R&D, employee relations)

— All other sources of company information; e.g. internal documentation, brochures and website.

Answer to Question No. 7(c)

Earlier all actions for environmental torts against companies and industries were governed by the principle of strict liability. Strict liability means liability without fault i.e., without intention or negligence. In other words, the defendant is held liable without fault. Absolute liability for the escape of impounded waters was first established in England during the mid-nineteenth century in the case of *Rylands* v. *Fletcher*.

Justice Blackburn's opinion in abovementioned case established broad liability for land owners whose land development activities result in the unexpected release of a large volume of water. The liability under this rule is strict and it is no defence to say that the thing escaped without that person's willful act, default or neglect or even that he had no knowledge of its existence.

In *M.C. Mehta* v. *Union of India*, AIR 1987 SC 1086, the Supreme Court sought to make a departure from the accepted legal position in *Rylands* v. *Fletcher* stating that an enterprise which is engaged in a hazardous or inherently dangerous activity that poses a potential threat to the health and safety of persons and owes an absolute and non-delegable duty to the community to ensure that no harm results to anyone. *The principle of absolute liability is operative without any exceptions. It does not admit of the defences of reasonable and due care, unlike strict liability. Thus, when an enterprise is engaged in hazardous activity and harm result, it is absolutely liable, effectively tightening up the law.*

The industries involving hazardous processes generally handle many toxic, reactive, and flammable chemical substances in the plant operations which are potential sources of different types of hazards at the workplace. If these hazards are not managed properly, the safety and health of the exposed population is adversely affected and become vulnerable to great risk.

Imposing an absolute and non-delegable duty on an enterprise which is engaged in a hazardous or inherently dangerous industry, the Supreme Court held that "in India we cannot hold our hands back at such a situation and wait for inspirations from England hence there is a need to venture so as to evolve a new principle of liability which England Courts have not done. We have to develop our own law and if we find that it is necessary to construct a new principle of liability to deal with an unusual situation which has arisen and which is likely to arise in future on account of hazardous or inherently dangerous industries which are concomitant to an industrial economy, there is no reason why we should hesitate to evolve such principle of liability merely because it has not been so done in England.

The Apex Court held that the measure of compensation in these kind of cases must be correlated to the magnitude and capacity of the enterprise because such compensation must have a deterrent effect. The larger and more prosperous the enterprise, greater must be the amount of compensation payable by it for the harm caused on account of an accident in the carrying on of the hazardous or inherently dangerous activity by the enterprise.

In Indian Council of *Enviro-Legal Action* v. *Union of India*, AIR 1996 SC 1466, a writ petition was filed before the Supreme Court alleging invasion of right to life because of pollution caused by private companies. The Supreme Court reaffirmed the rule laid down in oleum gas leak case stating that once the activity carried on is hazardous or inherently dangerous, the person carrying on such activity is liable to make good the loss caused to any other person by his activity irrespective of the fact whether he took reasonable care while carrying on his activity is by far the most appropriate one and binding.

TEST PAPER 5/2010

(This Test Paper is based on Entire Study Material)

Time allowed : 3 hours *Max. marks : 100*

NOTE: *Attempt ALL questions.*

PART A

Question No. 1

(a) Compete the following sentences by filling in the blank spaces with appropriate words :

(i) The Greenbury Committee was set-up to examine the___________ .

(ii) In terms of Clause 49 of Listing Agreements a director to be considered independent should not have been an executive of the company in the immediately preceding_________ years.

(iii) _______________ is seen as the first step of the board's continuing improvement.

(iv) Clause 49 provides that constitution of_______________ committee is a non-mandatory requirement.

(v) The primary role of________________ committee is to assist the board in identifying prospective directors. *(1 mark each)*

(b) Choose the most appropriate answer from the given option in respect of the following :

(i) As per Clause 49, the time gap between two board meetings should not exceed :

(a) Two months

(b) Three months

(c) Four months

(d) Six months

(ii) The Management discussion and analysis report is not required to contain discussion on :

(a) Industry structure and development

(b) Risks and concerns

(c) Justification of managerial remuneration

(d) Discussion on financial performance with respect to operational performance.

(iii) The third dimension of the triple bottom-line in addition to people and profit is :

(a) Social

(b) Economic

(c) Planet

(d) Moral

(iv) The supervisory Board under the German model is known as :

(a) As fusichstrat

(b) Vorstand

(c) Kiertsu

(d) Kyosei

(v) In terms of Clause 41 of the Listing Agreement, the announcement of the unaudited financial results should be made to stock exchanges with________of the conclusion of the Board Meeting :

(a) 30 minutes

(b) 15 minutes

(c) 1 Hour

(d) 24 Hours. *(1 mark each)*

(c) Discuss about the underlying principle to determine the independence of directors as contained in various codes and committee recommendations. (10 marks)

Answer to Question No. 1(a)

(i) The Greenbury Committee was set-up to examine the **remuneration of directors**.

(ii) In terms of Clause 49 of Listing Agreements a director to be considered independent should not have been an executive of the company in the immediately preceding **3 financial** years.

(iii) **Director Induction** is seen as the first step of the board's continuing improvement.

(iv) Clause 49 provides that constitution of **remuneration** committee is a non-mandatory requirement.

(v) The primary role of **nomination** committee is to assist the board in identifying prospective directors.

Answer to Question No. 1(b)(i)

(c) Four months.

Answer to Question No. 1(b)(ii)

(c) Justification of managerial remuneration.

Answer to Question No. 1(b)(iii)

(c) Planet.

Answer to Question No. 1(b)(iv)

(a) Aufsichtsrat.

Answer to Question No. 1(b)(v)

(a) 15 minutes.

Answer to Question No. 1(c)

The independence of independent directors is one of the most debated aspects in corporate governance. Independent Directors bring a valuable outside perspective to the discussion at the board. They also ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They act as the guardians of the interest of all shareholders and stakeholders.

Various committees and codes have brought up the issue of Independent Directors. To begin with, The CII's Task Force and the Kumar Mangalam Birla Committee have made efforts in the development of independent director's role , where the task force in its report said that "the identities of members of Board crucial to excellence is of course obvious. a mix of operational managers, who have the insider's perspective and external professionals, who bring in the outsider's cool detachment, will provide the collective capability that a Board needs."

Birla Committee agreed on the following definition of "independence":

"Independent directors are directors who apart from receiving director's remuneration do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the Board may affect their independence of judgment".

The Naresh Chandra Committee defined an independent director as follows:—

An independent director of a company is a non-executive director who:

1. Apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;
2. Is not related to promoters or management at the Board level, or one level below the Board (spouse and dependent, parents, children or siblings);
3. Has not been an executive of the company in the last three years;
4. Is not a partner or an executive of the statutory auditing firm, the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity;
5. Is not a significant supplier, vendor or customer of the company;
6. Is not a substantial shareholder of the company, i.e. owing two per cent or more of the block of voting shares;

7. Has not been a director, independent or otherwise, of the company for more than three terms of three years each (not exceeding nine years in any case):

   — An employee, executive director or nominee of any bank, financial institution, corporations or trustees of debenture and bond holders, who is normally called a "nominee director" will be excluded from the pool of directors in the determination of the number of independent directors. In other words, such a director will not feature either in the numerator or the denominator.

The term independent in Clause 49 of the Listing Agreement as under:

The expression 'independent director' shall mean a non-executive director of the company director is defined 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.

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

Question No. 2

(a) Write Short Notes on :

(i) Control Activities under the COSO Internal Control Framework.

(ii) Risk Transfer *(5 marks each)*

(b) Describe any five areas of accountability covered under the SA 8000.
(5 marks)

Answer to Question No. 2(a)(i)

An effective internal control system balances the risk and control and helps a company in exploiting vast opportunities This tool promotes efficiency, reduce risk of asset loss, and help ensure the reliability of financial statements and compliance with laws and regulations. Internal control consists of five interrelated components. The components are:

— Control Environment

— Risk Assessment

— Control Activities

— Information and Communication

— Monitoring

Control Activities

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, and reviews of operating performance, security of assets and segregation of duties.

Answer to Question No. 2(a)(ii)

Risk Transfer

Transfer of risk refers to legal assignment of cost of certain potential losses to another. The risks can be transferred to an organization that specialises in accepting them, at a price. There are 3 major means of loss transfer viz., (i) By Tort (ii) By contract other than insurance (iii) By contract of insurance. The main method of risk transfer is insurance. The value of the insurance lies in the financial security that a firm can obtain by transferring to an insurer, in return for a premium for the risk of losses arising from the occurrence of a specified peril. Thus, insurance substitutes certainty for uncertainty.

Answer to Question No. 2(b)

SA 8000 is an international standard for social accountability initiated by Council on Economic Priority Accredition Agency (CEPAA) conventions, the Universal Declaration on human rights and the Child. SA 8000 seeks to provide transparent, measurable and verifiable performance standards in various areas including the following areas:

— *Child labor* : No workers under the age of 15; minimum lowered to 14 for countries operating under the ILO Convention 138 developing-country exception; remediation of any child found to be working

— *Forced labor* : No forced labor, including prison or debt bondage labor; no lodging of deposits or identity papers by employers or outside recruiters

— *Workplace safety and health* : Provide a safe and healthy work environment;

take steps to prevent injuries; regular health and safety worker training; system to detect threats to health and safety; access to bathrooms and potable water

— *Freedom of Association and Right to Collective Bargaining* : Respect the right to form and join trade unions and bargain collectively; where law prohibits these freedoms, facilitate parallel means of association and bargaining

— *Discrimination* : No discrimination based on race, caste, origin, religion, disability, gender, sexual orientation, union or political affiliation, or age; no sexual harassment.

Question No. 3

(a) Discuss in detail about the elements of a sound internal control system. *(10 marks)*

(b) Deliberate on the role of media in Corporate Governance. *(5 marks)*

Answer to Question No. 3(a)

A system of internal control balances the risk and control in the Company which helps in exploiting business opportunities fully. The system of internal control facilitates the effectiveness and efficiency of operations, helps ensure the reliability of internal and external reporting and assists in compliance with laws and regulations. The following are the elements of a sound internal control system:

1. An internal control system encompasses the policies, processes, tasks, behaviours and other aspects of a company that, taken together:

   — facilitate its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the company's objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud and ensuring that liabilities are identified and managed;

   — help ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organisation;

   — help ensure compliance with applicable laws and regulations, and also with internal policies with respect to the conduct of business.

2. The system of internal control should:

   — be embedded in the operations of the company and form part of its culture;

   — be capable of responding quickly to evolving risks to the business arising from factors within the company and to changes in the business environment; and

   — include procedures for reporting immediately to appropriate levels of management any significant control failings or weaknesses that are identified together with details of corrective action being undertaken.

A sound system of internal control reduces, but cannot eliminate, the possibility of

poor judgement in decision-making; human error; control processes being deliberately circumvented by employees and others; management overriding controls; and the occurrence of unforeseeable circumstances.

A sound system of internal control therefore provides reasonable, but not absolute, assurance that a company will not be hindered in achieving its business objectives, or in the orderly and legitimate conduct of its business, by circumstances which may reasonably be foreseen. A system of internal control cannot, however, provide protection with certainty against a company failing to meet its business objectives or all material errors, losses, fraud, or breaches of laws or regulations.

Answer to Question No. 3(b)

Media is a platform where any crucial disclosures can be made for the benefit of the shareholders, be it a corporate body, company, organization, institution, non-governmental organization, governmental body, all of them needs to have a respectable image and reputation. In today's day and age of increasing competition, easy access to information and the media explosion - reputation management has gained even more importance.

Corporate Governance means that transparency and accountability is maintained by the organization. Proper and timely dissemination of information to the stakeholders is a important tool of Corporate Governance. Media here plays a crucial role in this timely disclosure of information.

Many companies are now using media to improve investor relations. Disclosures are made through press conferences, company's website is an excellent electronic platform. The investor relations function also often includes the transmission of information relating to intangible values such as the company's policy on corporate governance or corporate social responsibility. Recently, the field has trended toward an increasingly popular movement for "interactive data", and forms of electronic disclosure have become prevalent topics of discussion and exploiting media tool for the purpose of Corporate Governance.

Question No. 4

(a) *Discuss in detail the tools used by institutional investors to assess the health of a company.* *(8 marks)*

(b) *It is the board of directors who must provide intrinsic leadership and direction at the top of the organization. Elucidate the statement and also point out the difference between the roles of director and managers.* *(7 marks)*

Answer to Question No. 4(a)

Institutional investors remain alert while investing in a company; they assess the health of company before investing resources in it. Following are the tools used by Institutional Investors

(i) *One-to-one meetings*

The meetings between institutional investors and companies are extremely important as a means of communication between the two parties. This is one clear example of the way that individual investors are at a disadvantage to

institutional investors as corporate management will usually only arrange such meetings with large investors who are overwhelmingly institutional investors.

(ii) *Voting*

The right to vote which is attached to voting shares is a basic prerogative of share ownership, and is particularly important given the division of ownership (shareholders) and control (directors) in the modern corporation. The right to vote can be seen as fundamental tools for some element of control by shareholders. The institutional investors can register their views by postal voting, or, vote electronically where this facility is available.

(iii) *Focus lists*

A number of institutional investors have established 'focus lists' whereby they target underperforming companies and include them on a list of companies which have underperformed a main index, such as Standard and Poor's. After being put on the focus list, the companies often receive unwanted, attention of the institutional investors who may seek to change various directors on the board.

(iv) *Corporate governance rating systems*

A number of corporate governance rating systems come up with the development of corporate governance. Examples of such firms which have developed corporate governance rating systems are Deminor, Standard and Poor's, and Governance Metrics International (GMI). The ratings will also be useful to governments in identifying perceived levels of corporate governance in their country compared to other countries in their region, or outside it, whose companies may be competing for limited foreign investment. A corporate governance rating could be a powerful indicator of the extent to which a company currently is adding, or has the potential to add in the future, shareholder value. This is because a company with good corporate governance is generally perceived as more attractive to investors than one without.

Answer to Question No. 4(b)

According to Adrian Cadbury, if the company has to make the most of its opportunities, the Board has to be a source of inspiration for the goals it sets. The Board is responsible for the manner in which a company achieves its goals and therefore for the kind of enterprise it is and that which it aspires to become. The responsibility of the board is also to provide leadership in advancing the company's vision, values and guiding principles. The board is collectively responsible for promoting the success of the company by directing and supervising the company's affairs. The board sets the company's strategic aims, ensures that the necessary financial, human resources & infrastructure are in place for the Company to meet its objectives and review management performance. Leadership Development is identified as a special emphasis area by the board.

The Organisation for Economic Co-operation and Development in its principles of corporate governance has stated that:

"Together with guiding corporate strategy, the Board is chiefly responsible for

monitoring managerial performance and achieving an adequate return for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation. In order for boards to effectively fulfil their responsibilities they must be able to exercise objective and independent judgement. Another important board responsibility is to oversee systems designed to ensure that the corporation obeys applicable laws, including tax, competition, labour, environmental, equal opportunity, health and safety laws."

The differences between the directors and managers are discussed as under:

	Directors	*Managers*
Leadership	It is the board of directors who must provide the intrinsic leadership and direction at the top of the organization.	It is the role of managers to carry through the strategy on behalf of the directors.
Decision Making	Directors are required to determine the future of the organization and protect its assets and reputation. They also need to consider how their decisions related to 'Stakeholders' and the regulatory framework.	Managers are concerned with implementing the decisions and the policies made by the board.
Duties and responsibilities	Directors, not managers, have the ultimate responsibility for the longer-term prosperity of the company. Directors are required in law to apply skill and care in exercising their duty to the company and are subject to fiduciary duties. If they are in breach of their duties or act improperly directors may be made personally liable in both civil and criminal law. On occasion, directors can be held responsible for acts of the company. Directors also owe certain duties to the stakeholders of the company.	Managers have far fewer legal responsibilities.
Relationship with shareholders	Directors are accountable to the shareholders for the company's performance and can be removed from office by them or the shareholders can pass a special resolution	Managers are usually appointed and dismissed by directors or management and do not have any legal requirement to be held to account.

	Directors	Managers
	requiring the Directors to act in a particular way. Directors act as "Fiduciaries" of the share-holders and should act in their best interests but also taking into account the best interests of the company (as a separate legal entity) and the other stakeholders.	
Ethics and values	Directors have a key role in the determination of the value and ethical position of the company.	Managers must enact the ethos, taking their direction from the board.
Company Administration	Directors are responsible for the company's administration.	While the related duties associated with company administration can be delegated to managers, the ultimate responsibility for them resides with the directors.
Statutory Provisions on insolvency	If a company becomes insolvent, law imposes various duties and responsibilities on directors that may involve personal liability, criminal prosecution and disqualification.	These statutory provisions do not affect managers.
Statutory Provisions in general	There are many other statutory provisions that can create offences on strict liability under which Directors may face penalties if the company fails to comply. A very wide range of statutes impose duties on Directors which are numerous.	Generally managers are not responsible under the Statutory Provisions.
Disqualification	Directors can be disqualified as Directors under law.	The control over the employment of a Manager rests with the company.

Question No. 5

(a) Describe with reasons whether the following are ethically legally and/or right or wrong:

(i) Related party transaction

(ii) Democratization of workplace

(iii) Sale/purchase of shares by employees

(iv) Appointment of a friend of promoter as an independent director.

(2 marks each)

(b) Explain the need to communicate the goals, roles, expectations and priorities to employees. *(5 marks)*

Answer to Question No. 5(a)(i)

Related Party Transaction : Any such transaction which is at arm's length price is not legally wrong. A related party transaction which is at arms length will not be ethically wrong if such transaction is beneficial to the company and not the parties personally.

Answer to Question No. 5(a)(ii)

Democratization of workplace : This is legally and ethically correct. This will enhance the spirit of loyalty towards the organization

Answer to Question No. 5(a)(iii)

Sale/Purchase of shares of shares by employees : This is neither legally nor ethically wrong. However, when employees manipulate the prices based on unfair trade practice or insider trading then this becomes legally and ethically wrong.

Answer to Question No. 5(a)(iv)

Appointment of a friend of promoter as an independent director : The act of Appointment of a friend of promoter as a independent director is not legally wrong. It will be ethically wrong if the friend so appointed as independent director is unable to exercise his independence while at work.

Answer to Question No. 5(b)

For an effective ethic program following- Goals, Roles, Expectations, and Priorities should be communicated to the employees:

— Employees need to be frequently reminded of the short and long term goals of the job, so that employee's individual goals must support the organization's mission and vision. They should be made aware about how a goal accomplishment.

— Employees need to know how their job is important for the organisation and how they add value to the organization, to ensure that they understand what kind of conduct is expected from them.

— They should know about what exactly is expected from them, what is to be done, when, to what standards, how it is to be evaluated, what is to be done if they encounter any hurdle or unanticipated changes, how the conflicts is to be handled.

— Operational priorities of the organization should be clear in the minds of the employees.

For a successful, business ethics programs it should educate employees about formal ethical frameworks and more for analyzing business ethics issues and a written

Ethical policy of the organization will deter wrongdoing and promote honesty and ethical conduct.

PART B

Question No. 6

(a) *Explain in detail the Clarkson principle of stakeholder management. (8 marks)*

(b) *What are the important elements that should be included in the code of conduct? (7 marks)*

Answer to Question No. 6(a)

Following are the Clarkson Principle of stakeholder management, which emerged from the project undertaken by the Centre for corporate Social Performance and Ethics

Principle 1 : Managers should acknowledge and actively monitor the concerns of all legitimate stakeholders, and should take their interests appropriately into account in decision-making and operations.

Principle 2 : Managers should listen to and openly communicate with stakeholders about their respective concerns and contributions, and about the risks that they assume because of their involvement with the corporation.

Principle 3 : Managers should adopt processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.

Principle 4 : Managers should recognize the interdependence of efforts and rewards among stakeholders.

Principle 5 : Managers should work cooperatively with other entities, both public and private, to insure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.

Principle 6 : Managers should avoid altogether activities that might jeopardize inalienable human rights (e.g., the right to life) or give rise to risks which, if clearly understood, would be patently unacceptable to relevant stakeholders.

Principle 7 : Managers should acknowledge the potential conflicts between (a) their own role as corporate stakeholders, and (b) their legal and moral responsibilities for the interests of all stakeholders, and should address such conflicts through open communication, appropriate reporting and incentive systems and, where necessary, third party review.

Answer to Question No. 6(b)

The Code may include the following:

(a) Company Values.

(b) Avoidance of conflict of interest.

(c) Accurate and timely disclosure in reports and documents that the company files before Government agencies, as well as in Company's other communications.

(d) Compliance of applicable laws, rules and regulations including Insider Trading Regulations.

(e) Maintaining confidentiality of Company affairs.

(f) Non-competition with Company and maintaining fair dealings with the Company.

(g) Standards of business conduct for Company's customers, communities, suppliers, shareholders, competitors, employees.

(h) Prohibition of Directors and senior management from taking corporate opportunities for themselves or their families.

(i) Review of the adequacy of the Code annually by the Board.

(j) No authority of waiver of the Code for anyone should be given.

PART C

Question No. 7

(a) Fill in blanks with appropriate words/numbers :

(i) The Intergovernmental panel on climate change is an important milestone of _____________ .

(ii) _______________ have no immediate restriction under the UNFCC.

(iii) ______________ is a measure of human demand on Earth's ecosystem.

(iv) ________________ are the first global indices tracking financial performance of leasing sustainability driven companies' world wide.

(v) All COP submission under the UN Global compact after the initial submission are due within _______________ . *(1 mark each)*

(b) Write short notes on :

(i) Statement of Forest Principles

(ii) Sustainability context under RI principles

(iii) Rule in Rylands Vs. Fletcher. *(5 marks each)*

Answer to Question No. 7(a)

(i) The Intergovernmental panel on climate change is an important milestone of **United Nations Environment Programme** .

(ii) **Developing countries** have no immediate restriction under the UNFCC.

(iii) **Ecological Footprint** is a measure of human demand on Earth's ecosystem.

(iv) **DowJones Sustainability Indices** are the first global indices tracking financial performance of leasing sustainability driven companies' world wide.

(v) All COP submission under the UN Global compact after the initial submission are due within **1year** .

Answer to Question No. 7(b)(i)

Statement of Forest Principles

It is a non-Legally Binding Authoritative Statement of Principles for a Global Consensus on the Management, Conservation and Sustainable Development of all types of Forests. The guiding objective of these principles is to contribute to the management, conservation and sustainable development of forests and to provide for their multiple and complementary functions and uses.

Answer to Question No. 7(b)(ii)

The basic purpose of sustainability reporting is to show how an organization contributes or aims to contribute in the future, to the improvement or deterioration of economic, environmental and social conditions and trends, and developments at the local, regional or global level. This involves discussing the performance of the organization in the context of the limits and demands placed on environmental or social resources at the sectoral, local, regional or global level.

This concept is most articulate in the environmental arena in terms of the global limits on resource use and pollution levels. it can also be relevant with respect to social and economic objectives such as national or international socio-economic and sustainable developmental goals.

The organisation's own sustainability and business strategy policies provide the context in which to discuss performance. The relationship between sustainability and organizational strategy should be made clear as also the context within which performance is reported.

Answer to Question No. 7(b)(iii)

In the case of *Rylands* v. *Fletcher*, (1868) Blackburn, J first stated the rule of absolute liability meaning absolute legal responsibility for an injury that can be imposed on the wrongdoer without proof of carelessness or fault.

In the following words of Blackburn, J the rule was established:

> "We think that that the rule of law is, that the person who for his own purposes brings on his lands and collects and keeps there anything likely to do mischief if it escapes, must keep it at his peril, and, if he does not do so, is prima facie answerable for all the damage which is the natural consequence of its escape. He can excuse himself by showing that the escape was owing to the plaintiff's default; or perhaps that the escape was the consequence of vis major or the act of God…… and it seems but reasonable and just that the neighbour, who has brought something on his own property which was not naturally there, harmless to others so long as it is confined to his own property, but which he knows to be mischievous if it gets on his neighbour's, should be obliged to make good the damage which ensues if he does not succeed in confining it to his own property".

Simply stating that where a persons collects anything on his land which is likely to be mischievous in nature if it escapes, must keep it at his own risk, if any mishap happens he shall be liable for all the damages which is the natural consequence of its escape. He can defend himself by showing that the escape was owing to the plaintiff's default or it was the act of God.