YES ACADEMY
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CS PROFESSIONAL

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ESG

summary notes

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CHAPTER 1

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Ch 1 - Conceptual Framework of Corporate Governance

(0-5 mks Question - Direct)

* Corporate Governance (CG)

It is the application of best management practices, compliance with applicable laws in true letter & spirit and adherance with ethical standards for effective mgmt & distribution of wealth & the discharge of social responsibility for sustainable development of all stakeholders

* Advantages

a] ensures success of the corporate as well as economic growth
b] maintains & enhances investor confidence
c] Positive impact on the share price
d] minimizes corruption and wastages

* Need for CG

1) Corporate Performance
2) Increases investor confidence
3) Easy access of funds
4) Recognition in global market
5) Increase in valuations
6) Prevents / Reduces corruption
7) Crisis ↓
8) Accountability

* Scope / elements of CG (BBBRALM)

1) Board Independence - Effective governance requires an independent board and this can be acheived by appointing sufficient no. of IDs

and creating a balance between independent & non-independent directors.

2) Board meetings - Corporate Governance focuses on requiring the directors to devote sufficient time to all meetings in which they are associated & requires them to be throughly prepared before entering the Board room., it works on the premise that corporates with planned agendas & well prepared directors take more effective decisions

3) Board Induction & Training - Directors who have been appointed must be properly introduced to the company's Strategy, operations and the challenges being faced and at the same time company should provide adequate training to the directors to keep them up to date with all developments which may impact their corporate gov & other related duties

4) Risk Management - There should be clear established process of identifying, analysing and mitigating risk which could prevent the company from ~~acheiving~~ deviating from its objectives.

5) Monitoring - The Board should monitor & evaluate performance of directors individually & as a whole.

6) Audit Committee - The quality of audit committee contributes to overall governance of company

7) Legislation - There should be clear & unambiguous legislation which helps in promoting effective corporate governance, because those ~~interpretation~~ legislations which require more complex interpretations are more prone to monupulation & misinterpretation.

8) Board skills.
[For theories refer last pages of this book]

* Evolution of Corporate Governance.

1] Stockholm Conference 1972 - Magna Carta.

2] 1992 Rio Earth Summit

3] OECD 1998 - The OECD council issued a set of corporate governance standards and guidelines for promoting effective corporate governance which are dividen into five chapters:
a. Rights of shareholders
b. Equitable treatment to all shareholders
c. Role of stakeholders in corporate Governance
d. Disclosure & Transparency
e. Responsibilities of Board

4] Accountability for Sustainibility (A4S) - The A4S project was established with the aim to help businesses in making sustainable business decisions.

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· The A4S has 3 core aims:
a. To motivate the finance leaders to adopt sustainable business models.
b. Transform the financial decision making into an integrated approach which considers the risk posed by the organisation over the environment and social issues.
c. To scale up actions globally

5] Kyoto Protocol - · The Kyoto Protocol was signed majorly between the developed countries and adopted by other developing countries as well.
· It places heavier burden on developed countries under the principle of "common but differentiated responsibility."
· The protocol focuses on high level of GHG emissions in the atmosphere in which it focuses that all the countries must meet their targets through national measures.
· It further provides three market based mechanisms as additional means for countries to meet their targets:
1] International Emissions Trading
2] Clean Development Mechanism (CDM)
3] Joint Implementation.

6] ISO 26000 - ISO 26000 provides guidelines on social responsibility. It is not intended for certification but is created to guide organisations in understanding & integrating socially responsible practices into their everyday operations.

• Social Responsibility here means organisation's obligation to contribute to sustainable development while at the same time considering interest of all its stakeholders.

1. It defines social responsibility
2. Background and trends and characteristics of social responsibility
3. The practices relating to social responsibility
4. Issues concerning social responsibility
5. Integrating socially responsible behaviour throughout organisation.

✱ Governance from Indian Scriptures:

1] Ramayana

There are some relevent principles given in Ramayana which can be ~~so~~ summed up in the following points:

a] Governance has no inequality, hence theres should be no difference between rich & poor.
b] Governance structure should promote an environment of mutual trust & there should be no jealousy amongst the subjects.
c] Governance should promote commitment to duty.
d] It should promote education for all irrespective of gender.
e] Governance should promote good health of all persons in society.

2] Arthashastra

- It was literally meant to deal with the discipline of politics, but the scope of it is even wider to cover the government / laws / criminal courts / theories of war & duties & obligations of king.

- The following are essential for effective governance:
a] The King is a servant of the State.
b] He should be responsive, accountable & removable.
c] There should be strict ethical guidelines and code of conduct
d] It emphasises on stakeholder concept.

- As per this, the King has four fold duty:
a] Raksha - which literally means protection & can be equated with risk mgmt in the corporate scenario.
b] Vriddhi - means growth & can be equated with stakeholders value enhancement in the corporate scenario.
c] Palana - means compliance which can be equated to compliance with all applicable laws in letter & spirit.
d] Yogakshema - means wellbeing & which can be equated with CSR in present corporate scenario.

[audit com. / remn st. to remn policy / independence]

* Finnish Corporate Governance Code:

- The Finnish CG code works on a 'comply or explain' basis wherein it aims to promote openness with regards to CG & remuneration.
- It has many benefits which also includes more transparency which allows the stakeholders to evaluate the practices by the company
- The code focused on suggesting changes in audit committee and has replaced the remuneration statement to remuneration policy.
- Remuneration policy concerns the co's BOD & in future it shall also include the rest of the mgmt, on the company's website.
- In future the Board shall be required to report upon the independence of the Board members & about the policy as to how it decides that a board member is not independent.

* Italian Corporate Governance Code:

- It applies to all the listed companies and the adoption of this is on a voluntary basis.

- The code believes on 'substance over form' hence, this code works on a 'comply or explain' basis.

- The code recognizes that there are 2 types of boards:- 1 tier / 2 tier.

- Companies which follow 2 tier model have a segregation in the board, wherein one board becomes the supervisory board which is responsible for company's strategic guidelines and the other board i.e. the mgmt board shall be responsible for executing those strategies.

- The choice to depart from any reccommendation or any best practice suggested is with the company, but they have to explain each deviation, in particular:
a. which best practice has been disregarded.
b. The reason for the same
c. If the deviation is limited to time, then by what time they plan to apply the same.
d. What alternative practice the company has adopted.

* Japan's Stewardship Code - Principles for responsible inst. inv. (PRI)

- The code sets stewardship responsibilities for institutional investors to enhance the medium to long term investment returns for its beneficiaries.

- The stewardship activities includes monitoring of the investee company, having constructive dialogue with the company concerning sustainibility issues.

- If the institutional investors fulfil their stewardship responsibilities properly then it shall be better for the economy as well as for the investee company and the beneficiaries.

- The code categorizes institutional investors into asset managers and asset owners.

- Asset owners are those who provide their own funds & asset managers are those who manage the funds of others.

- They both are expected to contribute to the enhancement of corporate value of the investee company, while the asset owners are also expected to disclose their policies as to how they will fulfil their stewardship responsibility.

* Global Corporate Governance Forums

1] ~~Org~~ National Foundation for Corporate Governance (NFCG)
- The NFCG was created with the intent to promote Corporate Governance & its adoption in India.
- It was established in the year 2003 by the MCA in partnership with the CII, ICSI, ICAI.
- The mission of NFCG are:
(a) To foster a culture of good corporate governance ~~(b)~~ leading to voluntary compliances & facilitate participation of different stakeholders.
(b) To catalyze capacity building in emerging corporate governance practices.

2] The Institute of Directors (IOD) UK.
- The IOD was established in the year 1903 in UK which primarily was created with the task of creating an environment conducive to business success.

- The objectives of IOD are as follows:

(Development of skills) (a) To promote among its members skills / Knowledge / integrity and professional competence. (member here refers to directors)

(Research on CG) (b) To promote research and development and to disseminate new practices and laws promoting corporate governance.

(Represent int of members) (c) To represent the interest of its members as well as the business community in front of the government as well as ~~pu~~ other public fora.

(Protect int of members) (d) To protect and advance the interest of its members and provide services and facilities to them.

3] International Corporate Governance Network (ICGN)

- The ICGN was created in the year 1995 under the laws of England and Wales & the membership is open for all who are comitted for development of corporate governance.

- The ICSI is a member of ICGN & is the correspondent from India.

- It has four primary objectives:

(a) To provide an investor-led network which allows exchange of views on corporate governance internationally.

(b) To examine the current corporate governance principles and practices.

(c) To promote good corporate governance.

(d) To develop a culture of adherence to corporate governance standards.

- They do this by influencing policies by providing reliable source of investor opinion and connecting peers at the global events. to enhance the dialogue between the companies and investors

4] International Integrated Reporting Council (IIRC)

- The IIRC was established in year 2010 with the aim to formulate a framework which moves towards integrated reporting.

- It has the following mission & vision:

Mission: The IIRC's mission is to establish integrated reporting and thinking within mainstream business practice as the norm in the public & private sectors.

Vision:

1] To align the capital allocation (Natural, Mfg, Financial, Social, Human, Intellectual) and the corporate behaviour to acheive sustainable development.

2) It aims to develop a framework that:
(a) communicates the org's strategy / performance/ plan.
(b) To provide a coherent framework which can promote integrated reporting.
(c) which is internationally agreed so as to allow harmony among the players.
(d) which reflects the use and effects of all the capitals.

5) Corporate Secretaries International Association (CSIA)

- CSIA is an international organisation which has been created to promote the values and practices of governance professionals.

- The CSIA has issued practical steps to better corporate governance:
(a) Review relations between external auditors & co.
(b) Ensure director's remuneration packages are justifiable & justified.
(c) Emphasize Co. does not belong to directors.
(d) Review relations with SH incl. institutional inv.
(e) Check caliber of NEDs
(f) NED have necessary skills, exp & courage.
(g) Dir can access all info they need.

6) Asian Corporate Governance Association (ACGA)

- The ACGA has been established in the form of NPO which works with the investors / companies & regulators for implementing effective CG practices across Asia.

- The scope of work covers three areas:

(1) Research:
The body tracks the CG practices across various markets producing an independent analysis of the new laws and practices in the sphere of CG.

(2) Advocacy:
It refers to having constructive dialogues with the financial regulators / stock exchanges / investors and corporates on the practical issues which are affecting the application of CG across Asia.

(3) Education:
It conducts conferences & seminars which gives deeper understanding of the benefits of sound CG and ways to implement it.

7] The European Corporate Governance Institute (ECGI)
- The ECGI was founded in year 2002 to improve corporate governance by fostering research & related activities.

- This has been created in the form of an NPO which creates a forum to the legislators, academics & practitioners who can discuss upon the major corporate governance issues & how it can be better implemented.

- Their primary task is to conduct research & disseminate information on CG and it further also refers the best practices to the legislators for the formulation of effective CG policy.

- The Institute draws its expertise from scholars of numerous countries which in turn help in promoting better CG.

Vision:

1) To bring CG at the heart of the capitalist system. as this sits at the centre of success & failure of the economic system.

2) It aims to promote research and insights of the best thinkers / practitioners and policy makers & that is what the ECGI does by connecting scholars from various countries at one place.

Mission:

The mission of ECGI is to assist the top academics in the field of CG in bringing their research to the attention of leading practitioners, policymakers and thought leaders by making state of the art knowledge accessible & relevent to them.

8] Conference Board

- This was established in the year 1960 in US in the form of NPO which & is involved in research & dissemination of the knowledge about management and market place which helps businesses strengthen their performance & serve the society in a better way.

Mission:

1) To provide world's leading corporations with the knowledge they need to improve their performance.

2) To conduct research, make forecast, assess trends and publish information.
3) By promoting better CG it aims to promote public confidence in the regulations.
The CG programme has helped the corporations develop strong core principles which inturn helps in better governance.

* Evolution of CG in India (BBIMPNH)

1) In the year 1998 the CII formed the first CG code which was named as Desirable Corporate Governance - A code.

2) In the year 1999, SEBI formed a committee under chairmanship of Kumar Mangalam to raise the CG standards, reference of which was added as Clause 49 (CG under listing agreement)

3) In 2002, post the Enron scam Naresh Chandra Committee was appointed to review auditor-client relationship and the role of IDs. later on, under the Chairmanship of N.R. Narayanmurthy clause 49 was revised and revised clause 49 was added in reccommendations.

4) In 2004, the Government constituted the J.J. Irani committee to review & revise Companies Act, 1956 to which committee reccommended constitution of Stakeholder Relationship Committee & penal consequences if duties of directors not performed.

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5) 2013 → Companies Act, 2013 was passed.
2015 → SEBI (LODR) Reg, 2015 was passed.

6) In 2017, SEBI formed a committee under chairmanship of Uday Kotak committee:

Issues:

1) Disclosure and transparency related.
2) Improving effectiveness of Board Evaluation practices.
3) Improving safeguards relating to RPT
4) Issues faced by investors in voting & participation in GM.

Recommendations:

1) Composition & Role of BOD
2) Disclosures & Transparency
3) Investors participation in meetings of listed cos
4) Board Committees.
5) Institution of IDs.

Accepted changes:

1) Increase in transparency enhanced disclosure requirements.
2) Enhanced disclosure on RPT
3) Enhanced Quorum
4) Disclosure of Expertise / Skills of Directors.
5) maximum no. of directorships → capping.

7) 2019 NGRBC: There are 9 principles under NGRBC which are:

(a) Business should conduct and govern itself with integrity.
(b) It should provide goods & services that are sustainable safe.
(c) It should respect & promote well-being of

all its employees.
(d) It should respect & promote well-being of all its stakeholders
(e) It should respect & promote human rights.
(f) protect & restore environment.
(g) Business should promote inclusive growth
(h) Provide value to consumers in responsible manner.

8) 2020 Guidelines on Integrity & Transparency:
a) Integrity, Ethics and Governance
b) Responsible Governance & citizenship
c) IDs and women directors
d) Risk mgmt
e) succession Planning
f) Disclosure & Transparency related issues
g) Vigil mechanism

9) Business Responsibility Reporting
- This committee suggested a common format for all types of cos whether listed / unlisted to report upon their responsibility statement.
- Thereby, every co. needs to file BRR which contains non-financial as well as sustainibility related information.

* Sorbanes Oxley Act of 2002 (SOX):
- In the year 2002 after the Enron scam the US passed an act to protect sh.holders & public from accounting errors & fraudulent practices.

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The summary highlights of most important sections are as follows:

(a) section 302 (corporate responsibility for financial reports) :-

- The CEO & CFO are responsible to review all the financial reports, for internal accounting controls & to report any deficiency in same to AC.
- They are responsible to ensure that there has been no misrepresentation as well as that all info is fairly presented

(b) Section 401 :-

- All the FS must be accurate & does not contain any incorrect statement

(c) Section 409 :-

Disclose on real time any material change in financial condition.

(d) Section 806 :-

Whistle Blower Protection

(e) Section 902 :-

It shall be a crime if any person corruptly alters / destroys / conceals any document to hamper the official proceedings.

(f) Section 906

↳ $5m in fine &

↳ 20 years in prison.

* CG Principles and Recommendations, Australia, 2019

- The Australian CG code works on framework 'if not why not' i.e. it is not mandatory.

- It has 8 central principles (RRRMSISL)
1) Remunerate fairly & responsibly.
2) Recognize and manage risk.
3) Respect the rights of security holders.
4) Make timely disclosures
5) Safeguard integrity of corporate reports.
6) Instill culture of acting lawfully, ethically & responsibly
7) Structure Board to be effective & add value.
8) Lay solid foundation for mgmt & oversight.

(6-7 principles)

* New code of CG, Singapore - 2018

- It applies to all the listed companies on the Singapore SE and the principles provide for broadly accepted characteristics of good CG which companies are expected to comply.

Acceptable Principles:

1) The Board should have diversity and in particular appropriate level of independence.

2) The code recognizes two tier vote system in which there should be clear division of responsibility between the leadership of the Board & the mgmt keeping in mind that no, one individual can get unfettered power

3) The Board has a transparent process for the appointment and reappointment of its directors.

(miscellaneous) 4) The Board undertakes formal annual assesment

5) That a transparent procedure is inline for developing policies on director's remuneration & no director shall be allowed to decide his own remuneration.

6) There must be a balance while paying remuneration to a board which is in line with the performance & value creation of company.

7) The Board must have an audit committee

(mistellaneous) 8) The Board treats all ~~hi~~ its shareholders fairly & equitably & communicate with them whenever required.

9) The Board is responsible for the risk governance and to maintain a sound risk mgmt system

Note: Tenure of ID same as Malaysian CG code (9 years + two tier voting)

~~(atleast 6-7 principles).~~

* KING IV report on CG - South Africa, 2016.

1) Leadership, Ethics and Corporate Citizenship:

a) The governing body should lead ethically

b) The governing body should promote ethics in the organisation so that there could be established ethical culture in the organisation.

(m) c) They must see that the organisation is seen as a responsible Corporate citizen.

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2) Governance Structure :
a) The Governance body should be responsible for promoting CG
b) The body must comprise of appropriate balance of knowledge, skills, expertise and independence.
c) The governing body is responsible for its evaluation of the Board / individual dir / committees.

3) Governance functional area :
a) The governing body should be responsible to govern risk in a way that supports organisation's strategic objectives.
b) The governing body should be responsible for the compliances of org.
c) It should be responsible for remunerating fairly and in a way that retains the existing and motivates the outside talent

4) Stakeholder Engagement:
a) The Board should adopt a stakeholder inclusive approach which balances the interest of all its stakeholders.

* OECD Principles of CG

1) Ensuring basis for an effective CG framework:

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2) Rights and equitable treatment of shareholders

a) Basic shareholder rights:
- Right to get the ownership registered.
- Right to transfer shares
- Right to vote
- Right to dividend.

b) Shareholders should be informed about any of the following fundamental corporate changes:
- Any extraordinary transaction.
- Issuing of additional shares
- Any amendment to the charter documents of the company.

c) In order to enable them to vote and effectively participate they should be sufficiently informed about the following:
- The day, date & time and venue of GM
- Agenda of meeting alongwith any explanatory statement.
- A process and procedure of voting
- How the shareholders can ask questions to the Board.

d) Equal class of shareholders must be treated equally

e) RPT must be managed in a way which supports the interest of the company.

f) minority shareholders should be protected against abusive actions by controlling shareholders.

3) Disclosure and Transparency:

a) The disclosures should include the following:
- The financial & operating results of company
- other non-financial information incl company's objectives
- RPT
- Info about the skills required and about those which are possesed by the Board.

b) Disclosures should be made using high quality standards of financial as well as non-financial reporting.

c) Annual audit must be conducted by an independent auditor using high quality auditing standards.

d) The auditor should be accountable to the shareholders.

e) The channel for disseminating information should provide for equal, timely and cost-efficient access of information.

4) The role of stakeholders in CG:

a) Respect the rights of stakeholders which are established by law or mutual agreement.

~~b)~~

b) The stakeholders must be provided with adequate & effective redressal for violation of their rights.

c) The stakeholders should have access to relevent and reliable information.

d) The stakeholders should be able to freely communicate any unethical or illegal practices.

5) Institutional investors, stock markets and other intermediaries:

a) Institutional investors should disclose their CG and voting policies.

b) Votes by the custodian should be inline with the directions of the beneficial owners of the shares.

c) The institutional investors should disclose how they manage material conflict of interest

d) Insider trading & market manupulation should be prohibited.

e) The proxy advisors/analysts/rating agencies must disclose as to how they manage conflict of interest.