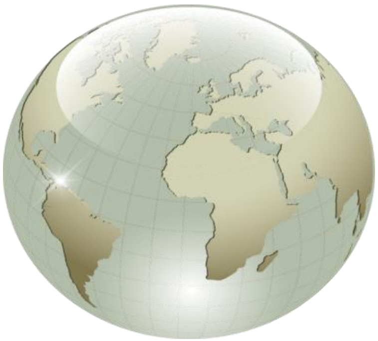

AUDIT OF CORPORATE GOVERNANCE PRACTICES

"Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society."

Sir Adrian Cadbury, UK, Commission Report: Corporate Governance 1992

Publication of the **Regional Training Institute, Mumbai**
[Indian Audit & Accounts Department]

Knowledge Partner Verita Management Advisors Pvt. Ltd

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Index

About the Regional Training Institute (RTI), Mumbai

The Regional Training Institute (RTI), Mumbai is one of the nine RTI of the Indian Audit & Accounts Department situated through-out the country. The RTI caters to the training requirements of 15 user offices of Indian Audit & Accounts Department located in the Maharashtra and Goa states. In some specialized courses like Environmental Auditing, Corporate Finance, Corporate Governance, Audit of Municipal Corporations, Development of Management Skills etc., participants are nominated countrywide. Moreover, on need basis, we meet the training requirements of Auditee organizations such as MSETC, MHADA. The RTI functions on an advice rendered by the Regional Advisory Committee (RAC) notified by the Comptroller and Auditor General of India. The RAC represents 15 user offices & is headed by senior most D. G. level officer. The training need analysis is done in each user office to ascertain the training requirement. The Annual Training Calendar is finalized after receiving the training requirements from user offices in RAC meeting after detailed discussion. This institute is headed by a Principal Director (Sr. Administrative Grade) who is assisted by a team of Core Faculty and supporting staffs.

Preface

Audit officers of the Comptroller & Auditor General (C & AG) of India regularly undertake audit of Corporate Governance practices of Public Sector Enterprises (PSEs) in India. The purpose of this publication on the subject of Audit of Corporate Governance is to provide a comprehensive technical reference point to the audit officers of the C & AG. This publication shall serve the academic and audit execution interests of the audit officers by providing them detailed audit guidance while they cover the area of Corporate Governance in auditing public sector enterprises.

RTI has developed this publication with the professional assistance of Verita Management Advisors Pvt. Ltd. Verita specialises in the areas of Governance, Risk and Compliances, Direct and Indirect Taxation and process outsourcing. In particular RTI acknowledges the exemplary efforts of Mr. Huzeifa Unwala, Board Member, Verita Management Advisors Pvt. Ltd for his contributions in this publication.

Foreword

K. P. SASIDHARAN
Director General of Audit (central)

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Foreword

The ever changing business environment fraught with increasing scales and complexities and the need to promote greater accountability amongst corporate management have given rise to the need for effective corporate governance regulations.

The principles of corporate governance form the cornerstones and revolve around the basic interrelated segments of integrity and fairness, transparency and disclosures, and accountability and responsibility.

An onerous responsibility is cast on auditor to certify compliance with corporate governance guidelines to stakeholders and regulators. Approaching audit with full awareness of role of auditor is thus vital.

It is against this backdrop that the Regional Training Institute, Mumbai as a Knowledge Centre of the Department in Audit of Corporate Governance has taken up the task of coming out with a comprehensive checklist to facilitate auditing compliance of all issues relating to Corporate Governance. The checklist enumerates 118 checkpoints across five main categories viz Leadership & corporate citizenship; Board of Directors & Board Committees; Disclosures & Transparency; Accountability and other issues. The checklist will be a powerful audit tool to the field audit officials to test compliance of the auditees under each checkpoint and to express an opinion on the quality of Corporate Governance.

Any knowledge dissemination effort in the department finds immediate appreciation and acceptance only if can lend itself to being used as a practical guide by the field audit officials. In this context this audit checklist is most welcome and I am sure it would achieve its intended purpose.

I would like to commend the efforts of RTI and the team of professionals led by CA Huzeifa Unwala of Verita in bringing out this very useful document for use in audit. I wish them all success and hope RTI Mumbai comes out with more such insightful material in future.

K P Sasidharan,
I A & A S
Director General of Audit (Central), Mumbai

Expert Point of View

Game changers for effective Governance in PSUs

Given that the PSUs of our country are today poised to release huge shareholder value if they are well Governed, the initiative to audit Governance practices is both timely, and extremely valuable. The correlation between excellent Governance and value in the market place has never been stronger. The time to reach the zenith of great Governance is “now”.

The most important aspect to get right is to create the right Board structure. The upper limit of Board size may be set at 10 with at least 50% independent members. The attributes that every independent director should possess are integrity, competence and commitment. The diversity on the Board can come from a unique set of experiences, a geographic spread and at least two women. The tenure of each independent director should be a fixed five years.

Every year a careful evaluation of presence, contribution and leadership should be documented and renewal for a further term of 5 years must be predicated on a high Evelyn of documented performance. The appointment must be made by a Nomination and remuneration committee and compensation must be set at reasonable levels per meeting of Board or time demanding committee and a commission based on profits and evaluated performance. Unless Board compensation is on par with Corporate India's best practices, the ability to attract and retain the right talent will be severely constrained. The specious argument of reputation effect of serving on a PSU board must be buried. The strictest norms of independence can be enforced and any attempt to gain undue influence over contracts or appointments must be put down with severity only thus will a great base of directors will evolve. An inspirational prize for the best PSU director may be established independently.

Three committees are crucial, the Audit and compliance committee, the Nomination and remuneration committee, and the stakeholder relationship committee. The remit of these committees can be drawn completely from the Companies Act and the regulations made. Each committee, at its first meeting must eyeball the remit and add to it based on the individual setting of each PSU. The committee chairperson should be elected by the committee itself and there should be a majority of independent directors on each committee. Fixed tenures, rotation and refreshment must be built into the DNA of each committee. The objective must be to make every meeting feel better than the previous one. Mandatory self evaluation to be documented by the Company Secretary after every meeting will drive this framework of continuous improvement. Once initiated the positive benefits of these practices are incalculable.

AUDIT COMMITTEE

With the constitution and DNA as articulated in the previous, section the Committee would be set to attain world beating benchmarks. The committee must set out the desired AUDIT and COSTING practices through extensive interaction with the concerned Auditors. The chief of these functions must always have a direct reporting relationship to the Committee and its Chairperson. Only then will independence and courage emerge. The protection of whistle blowers and the thorough investigation of frauds must be a part of the remit. The appointment of the Chiefs, their increments based on objectively evaluated performance and the exit interviews must be part the remit. Internal Audit must follow the business model.

Reporting must be in the context of trend in performance, comparison with budgets and with Global best practices. Audit must report on whether world class policy and systems and process driven frameworks have been established. Compliance, ethical conduct and conflict free actions are non negotiable requirements for any PSU. These must be emphasised along with an accent on physical and externally objective appraisals of assets. The auditors both internal and statutory must have free access and a chance to have in camera meetings with the committee. Also implementing executives must remain present when their functions are being discussed. A tracker by person and by time must be established and inputs to the Knowledge management system must emerge from every Audit Committee.

STAKEHOLDER RELATIONSHIP COMMITTEE

This committee must mandate the establishment of a one on one relationship with every shareholder. Every share must be dematerialised. Every address and every nomination must be up to date. Any comments on non or late receipt of annual reports and dividends must be seriously investigated. The target for the Secretarial department must be to have a complaint free relationship with every shareholder. Only when this aspect is given serious and continuous attention will outcomes be as desired.

NOMINATION AND REMUNERATION COMMITTEE

Selection of the CEO and fresh Board members must be the remit of this committee. Objective evaluation, fair treatment and protection against external defamation or frivolous litigation must also be established by this committee. As this is a crucial committee which must have an external and internal face, the Board Chairman's presence on the committee is valuable. Self appraisal and appraisal of the Board and a fair communication of feedback are all remits. The quality of this committee will determine the ultimate efficacy of the Board.

In addition to these committees, whose outputs and decisions must be summarised for the Board, other sub committees may be established for special purposes. Large Capex projects, significant acquisitions and divestments and other non- recurring but intensely time consuming tasks are often handed over towelling constituted sub committees. The Board chairperson must constitute and appraise all such committees. They must not be allowed to linger once their task is accomplished.

If a PSU board is supported by effectively functioning committees as outlined above, it can dedicate a majority of its time to strategic discussions which can change the destiny of the enterprise. It is not unusual for Boards which are well organised to challenge proposals which may appear good to go. Changes from brown field to Greenfield Capex allocations, the rejection of seemingly attractive corporate actions or the choice of policies in the light of emerging challenges are examples of what a good Board may achieve as outcomes. The challenge is to set an appropriate agenda, to encourage participation in a open manner and to respect views as well as consensus or majority outcomes.

If these practices can be targeted upward o City, State, National and International Governance, we can look forward to a future which will seem guided by the will of the people. Good Governance is Good trusteeship in essence.

- By **Shailesh Haribhakti**, Chartered Accountant.

Overview

According to the International Finance Corporation (IFC World Bank Group) Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders. Good corporate governance helps companies operate more efficiently, improve access to capital, mitigate risk and safeguard against mismanagement. It makes companies more accountable and transparent to investors and gives them the tools to respond to legitimate stakeholder concerns such as sustainable environmental and social development. Corporate governance also contributes to development. Increased access to capital encourages new investments, boosts economic growth, and provides employment opportunities.

Corporate Governance (CG) is defined as the system by which companies are directed and controlled. Sound corporate governance is an important element of sustainable public and private sector development. CG strengthens businesses' ability to attract investment and grow, because it makes them, stronger, more efficient, and more accountable.

The OECD Principles of Corporate Governance provide the framework for identifying the rights and equitable treatment of shareholders and other financial stakeholders, the role of non-financial stakeholders, disclosure and transparency, and the responsibilities of the Board of Directors. The *OECD Principles* are universally applicable to all types of corporate governance systems in countries at all levels of economic development.

Corporate Governance Emerging Regulatory Landscape

The mandatory and non-mandatory corporate governance related regulatory requirements in India have significantly evolved over a period of last decade or so. As the Indian economy integrates with the globe and Indian businesses transition to the next cluster unique risks/ threats emerge which require sharp regulatory responses and enforcements. Existing provisions under the listing agreement popularly known as the Clause 49 requirements have been overhauled by the Companies Act 2013 and recent recommendations of SEBI have aligned India's corporate governance regime with the developed countries.

The SEBI may need to amend the current listing agreement to bring it in line with the Companies Act, 2013. Key recent regulatory amendments enacted under the Companies Act, 2013 that would have a far reaching impact on Corporate Governance Systems and Practices in India are highlighted in segments hereunder:

S. No.	New provisions	Likely impact
1.	In prescribed class of companies there should be at least one woman director.	This is an acknowledged best practice and shall provide much needed diversity to the Board composition in addition to empowering women.
2.	Each company will need to have minimum one director who stayed in India for at least 182days in the previous calendar year.	This shall ensure that companies cannot be formed with all non-resident directors
3.	Every listed company shall have at least 1/3rd of the total number of directors as independent directors	This is an acknowledged best practice and shall provide much needed diversity to the Board composition.
4.	Limiting the liabilities of Independent/ Non-Executive Directors (NED)	This shall protect Independent/ Non-Executive Directors
5.	Setting up of Vigil mechanism in prescribed manner by listed and other prescribed class of companies	This shall strengthen surveillance mechanisms
6.	Every company which consists of more than 1000 shareholders/ debenture holders/ deposit holders or any other security holders at any time during the financial year shall constitute a "Stakeholders Relationship Committee" which should be chaired by a NED.	This shall act as a safety net to protect stakeholder interest and is an acknowledged best practice.
7.	No compromise or merger arrangement to be sanctioned by the Tribunal unless the Company's auditor has issued a Certificate on accounting treatment.	This shall act as a safety net to protect stakeholder interest and also improve financial disclosures.
8.	Class Action Suits can be initiated by specified number of members/ depositors except in case of a Banking Company	This shall act as a safety net to protect stakeholder interest, improve transparency and ensure participation of minority in key decisions.
9.	Service of documents, maintenance of accounting and secretarial records in electronic form	Better efficiency and improved transparency/ disclosures
10.	Annual returns to carry information only relevant to the Financial Year	Stress on relevant disclosures only
11.	"Fraud" is defined in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or loss.	Clarity on the remit of Corporate Fraud to ensure less legal controversies and enforcement of punitive actions.
12.	Auditor to report to the Central Government any offence involving fraud.	Auditor to act as whistle blower in addition to auditing responsibilities
13.	Class of companies qualifying the eligibility criteria to spend	Uplift societal interests, Corporates

	2% of average net profits in every financial year on prescribed CSR activities such as poverty alleviation, education, etc	expected to partner with Government in bringing a social transformation in the country.
14.	Listed companies will be given an option to have one director elected by the small shareholders.	This shall act as a safety net to protect stakeholder interest, improve transparency and ensure participation of minority in key decisions.
15.	A person will be able to hold directorship in 20 companies, of which not more than 10 companies can be public companies.	To ensure quality time and attention is given by the Directors to the affairs of the company
16.	The maximum number of directors has been set at 15 and the same will be applicable to all companies. For any further increase in number of directors, the company will need to pass a special resolution at its General Meeting.	To ensure quality time and attention is given by the Directors to the affairs of the company
17.	Every listed company will have at least one-third of total number of directors as independent directors, with any fraction to be rounded off as one. In case of any change in the circumstances which may affect his status as an independent director, the independent director will have to give a declaration that he meets the criteria of independence. The independent director may be selected from a data bank maintained by anybody, institute or association, as may be notified by the Central Government. An independent director will not be entitled to any stock options in the company.	This is an acknowledged best practice and shall provide much needed independence and diversity to the Board composition and protection of minority interests.
18.	Detailed "Code for independent directors" containing detailed guidelines for professional conduct, roles and responsibilities.	Clarity on the role and responsibilities of the independent directors.
19.	National Financial Reporting Authority (NFRA) to be established to oversee formulation of accounting and auditing standards and monitor audit firms.	Independent check on the activities of professional accounting bodies, standard setting bodies and audit firms.
20.	Provisions for mandatory rotation of auditors, restrictions on provision of conflicting professional services	Improved corporate control environment and governance practices.
21.	A company cannot make investment through more than two layers of investment companies, with exceptions.	Improved disclosures and reducing the likely hood of related party transactions.
22.	A related-party transaction can be entered into only if it is approved by a resolution at the general meeting.	Improved disclosures and arm's length pricing of transactions/ business deals.
23.	A company having one or more subsidiaries shall prepare Consolidated Financial Statement, in addition to financial statements, which shall also be laid before the annual general meeting of the company.	Improved disclosures and informed investment decision making.
24.	The Directors' Responsibility Statement disclosures have been enhanced to include- (a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures; (b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period; (c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities; (d) the directors had prepared the annual accounts on a going concern basis; and (e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.	Improved corporate control environment, disclosure and governance practices.

Perception of Corporate Governance in the public sector

While listed PSUs are required to comply with Clause 49 of the SEBI Listing Agreement, it is now mandatory for all Central Public Sector Enterprises (CPSEs) to comply with the corporate governance norms rolled out by the Department of Public Enterprises. The general view is that from a regulatory perspective, PSUs are not lagging behind.

The non-executive directors on the PSU boards have been making a significant contribution in improving the overall functioning of PSUs through their insights and external perspectives

When it comes to corporate governance, it is also an issue of perception. The private sector has definitely scored in perception management – i.e., in projecting the corporate governance practices they have voluntarily adopted in their quest for improved transparency and accountability. PSUs and especially those that are unlisted should be transparently disclosing their corporate governance practices which have hitherto not been the case.

Audit of Corporate Governance practices shall enable PSUs in implementing best in class corporate governance practices leading the way rather than following the private sector.

Challenges of Corporate Governance in India

Corporate governance practices in India are still evolving. It is a process of engaging shareholders and the management effectively to enhance the organization's value. It involves participation of various stakeholders and management, communication, exchanging and validating ideas, and consultations. Hence, corporate governance is essentially a function of the mindset and culture prevalent in the organization's operating environment. Corporate governance cannot be looked at in isolation; it is heavily influenced by the overall governance eco-system. Recent scandals in corporate India have raised questions not only about the practices adopted by companies to solicit business but also about the standards of accountability in public administration including within the government machinery and institutions. The larger governance issues external to the enterprise will need to be addressed along side governance issues within the enterprise. Corporate governance in India faces its own set of challenges which are set out below

There is a gap between corporate governance standards in the public sector and the private sector. PSUs are subjected to varying levels of government interference in their routine functioning, undermining their autonomy. Further, restrictive and outdated labour laws in India make laying off employees and closing businesses difficult. Many PSUs which ceased operations decades ago still own and maintain obsolete properties and machinery and pay their staff while the government debates their future. In FY2011, about a third of India's 249 state owned companies collectively lost $3.4 bn.

There is substantial room for improvement in enhancing accountability. Within many board rooms in India, the topic of CEO succession is not often discussed. CEO succession planning calls for wider debate and rigorous processes than the ones currently followed, especially in owner-managed businesses. Also, boards need to be held more accountable for their decisions and actions.

Although India has numerous regulations, their enforcement is quite weak. Numerous government departments, multiple layers of bureaucracy and complex power sharing equations among them stifle stringent enforcement of regulations. Private enforcement i.e. enforcement by shareholders and market intermediaries is weak too.

There needs to be an objective debate in corporate India about what is required to be done to make Independent directors more effective. In the past, there has been a tendency to blame independent directors for governance issues. It is important to address the challenges such as true independence, developing the institution and pool of personnel with diverse skill sets who can provide exemplary board service and improve corporate functioning and taking concrete measures to improve their functioning through a combination of orientation, training, clear roles and adequate remuneration.

The post financial crisis era has witnessed a marked rise in investor activism. This is particularly true of institutional investors who have longer term interest in a company and have a greater say in its functioning. However, investor activism in India is relatively muted. As experience has shown, greater investor scrutiny could bring about substantial improvement in corporate governance. This is an important area where India needs to catch up with the developed world fast.

The regulation and scrutiny of the audit profession in India could benefit from some objective introspection.

It is expected that the Companies Act 2013 and the rules framed there under shall provide clarity on enhanced corporate governance practices and align Indian governance regime with that of the developed nations.

Why Corporate Governance matters?

1. In emerging markets like India the subject of CG is widely discussed and chronicled among policymakers, academicians and auditors as corporate governance plays a vital role in improving access to capital for emerging market companies. An increasing volume of empirical evidence indicates that well-governed companies receive higher market valuations. Improving corporate governance will also increase all other capital flows to companies in developing countries: from domestic and global capital; equity and debt; and from public securities markets and private capital sources.

2. Improving performance. Equally important and, irrespective of the need to access capital, good corporate governance brings better performance for companies. Improved governance structures and processes help ensure quality decision-making, encourage effective succession planning for senior management and enhance the sustainability of companies and lesser corporate scams.

3. Unlocking the wealth generation abilities of PSUs in India
4. Protection of shareowners and minority interests.
5. Balancing of social interests, financial stability and sustainability of corporates.
6. Much improved investor confidence and market sentiment, greater ability of corporates to attract and retain talent, etc.

What comprises of a company's Corporate Governance System?

Corporate governance issues arise from the roles of agency and stewardship. Agency involves the transfer of capital from the shareowners to the control of managers. Stewardship refers to the directors' role as guardians of the company's assets. The shareowners, through the board, delegate authority to management and entrust the board to act on their behalf. These roles are important when a company's owners (e.g., the shareowners) are different from its managers. This separation of the ownership and control functions within a company inevitably leads to the managers being made responsible for the spending of other people's money.

1 Laws that govern the company	2 Corporate Governance codes, Listing agreements, Business responsibility reporting	3 Constitutional framework of the company including articles of association, shareholders agreement,
4 Board of Directors who act as the conduit between the shareowners and managers of the company	5 Company Policies & Procedures. The code of ethics/ conduct	6 Culture of the company.

Why we need to audit Corporate Governance system?

Corporate governance is a strategic activity that ensures that all processes that are necessary for directing and controlling a business enterprise are implemented effectively. Audit of corporate governance processes provides assurance to the various stakeholders that all the required governance activities have been accomplished and what remains otherwise thereby assisting stakeholders in making an informed decision. Stakeholders don't like to receive surprises and audit of corporate governance activities shall ensure and effective check mechanism on the supervisory and managerial layers of a business enterprise.

Scope of Audit of Corporate Governance activities (CGA)

The gamut of CGA is wide and generally boundary less, as the subject covers:

1. Financial and non-financial stakeholders
2. Boards of Directors (Composition, mix, independence);
3. Control Environment (Accounting, Controls, Internal and External Audit); and
4. Risk Management
5. Transparency and Disclosure.

At the same time, it does not include, although it may reinforce, the following:

2. Corporate Social Responsibility / Corporate Citizenship;
3. Socially Responsible Investing;
4. Other Elements of Sustainability;
5. Political Governance;
6. Business Ethics;
7. Anti-Corruption / Anti-Money Laundering.

General approach for audit of CGA

1. The auditor is expected to familiarize him/herself with the business, sector, competition and annual disclosures of the auditee. The auditor should conduct a detailed research on the corporate governance practices of the company pre-appraisal.

2. Understand the elements of the Corporate Governance Program, applicable laws and regulations. Build a relationship with the officer or director of the Company charged with overseeing development of, and compliance with the Company's governance policies and.

3. Make periodic contact with members of the board of directors of the Company and inquire about the functioning of the board and whether the directors believe the board is effectively carrying out its roles to add value to management and protect shareholders and other stakeholder interests.

4. Keep abreast of developing corporate governance standards in the relevant market and internationally. Encourage the Company to take these into consideration and adopt them appropriately to the Company's particular circumstances.

5. Be on the lookout for corporate governance challenges (conflicts cases, Chairman/ MD/ CEO succession, special accounting issues, increasing complexity of the business), and think about additional assistance the Company may need to adjust its governance practices to meet such challenges.

Audit of Corporate Governance System

Accountability

1. Check there is separation of ownership and control.
2. Check whether executive management is accountable to Board
3. Check whether Board is accountable to shareowners
4. Check whether there is a Board Charter
5. Check whether the independent directors have powers to play their role effectively
6. Check whether the auditors of the company have full access to information and authority to present their view points at Board meetings
7. Check whether the company has policies on ethical marketing practices, bribery and dishonesty, employee and customer privacy, fair employment practices, gifts, entertainment, related party transactions and conflict of interests

Fairness

1. Check whether all shareowners, including minorities are treated equitably
2. Check whether there are defined procedure for effective resolutions of violations
3. Check whether the company has pricing policy and fair market practice code

Transparency

1. Investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected.
1. Check whether there is a timely, accurate disclosure on all material matters, including: financial and non-financial information, performance, ownership, frauds, going concern crisis and governance
2. Check whether the company has a policy for making political contributions
3. Check whether the company has comprehensive insider trading disclosure and compliance practices
4. Check whether shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.
5. Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

Responsibility

1. Check whether there is recognition of stakeholders rights, social responsibility and business sustainability requirements
2. Check whether the Board's responsibility includes review and guiding of corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.

Shareholder Interests

1. Check whether shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents

of the company; 2) the authorisation of additional shares; and 3) extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.

2. Check whether capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.
3. There exists rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.
4. The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.
5. Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.
6. Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

Checklist

Background

Audit officers of the Comptroller & Auditor General (C & AG) of India regularly undertake audit of Corporate Governance practices of Public Sector Enterprises (PSEs) in India. The purpose of this section is to provide a comprehensive checklist reference point to the audit officers of the C & AG. Theensuing audit checklist shall serve the academic and audit execution interests of the audit officers by providing them detailed guidance while they audit the Corporate Governance systems and related controls in Public Sector Units (PSUs).

Pre-Audit Commencement

Prior to audit commencement it would be appropriate that the audit officer develops a sound understanding of the business and risk environment, management and governance practices of the PSU. Aninformation questionnaire should be circulated to collect specific information and records that would be relevant in the audit of Corporate Governance practices of the PSU. Prior to the field work it is advisable to obtain following information:

1. A complete set of most recent documents like the corporate policies, delegation of powers, operating procedures, annual reports including directors reports, audit reports, secretarial audit reports, minutes of Board/ Audit Committee/ Other committees

2. List of associated enterprises, related parties, director and employee annual disclosures on income/ conflict of interest/other relevant aspects impacting governance

3. In case of Public listed entities discussion with the statutory auditors on the corporate governance certification report and major concerns (if any)

4. Status of investor complaints received by the PSU, published reports (negative) from credit rating agencies/ equity research agencies/ media on governance practices of the PSU

Basis study of the above information the audit officer should decide the audit coverage and extent of substantive verification.

Audit Checklist

This section lays down detailed checkpoints arranged sequentially on all significant aspects to be considered while undertaking audit of Corporate Governance practices of the PSUs.

Compliance Area [Part A – Leadership, Corporate Citizenship]		Auditor Remarks/ Observations
	1. Whether the company has designed and implemented a code of ethical business conduct? 2. Whether the company has designed and implemented policies and strategies in relation to economic, social and environmental impacts? 3. Whether the directors have provided an ethics performance statement in the annual report of the company? 4. Whether the company has prepared an ethics risk profile? 5. Whether the company has communicated the ethics policy/ Code of conduct (CoC) on its website? 6. Whether all employees have been trained on the ethics/ CoC? 7. Whether the Board has reviewed the performance and effectiveness of the implementation of the company's CoC? 8. Whether the company has established a suitable employee conduct monitoring mechanism? 9. Whether the company has obtained annual declarations from the Board and Key Managerial Personnel (KMP) of their compliance with the CoC? 10. All Board members and senior management personnel shall affirm compliance with the CoC on an annual basis. Whether the Annual Report of the company contains a declaration to this effect signed by the CEO? 11. Whether the company contributes has designed and implemented a CSR policy? 12. Whether the company has a dedicated Board Committee for undertaking formulation and review of CSR activities? 13. Whether the company has earmarked prescribed profit contributions towards annual CSR activities such as poverty alleviation, education, etc? 14. All Board members and senior management personnel shall	

	affirm compliance with the CSR policy on an annual basis. Whether the Annual Report of the company contains a declaration to this effect signed by the CEO? Whether reasons for non-compliance with the CSR policy have been disclosed in the annual report of the company?	

Compliance Area **[Part A – Leadership, Corporate Citizenship]**	**Summary Opinion of Auditor** **[Descriptive narration of areas of improvement]**

Overall Audit Rating:

- **Excellent (Level 5)**
- **Good (Level 4)**
- **Satisfactory (Level 3)**
- **Poor (Level 2)**
- **Unacceptable (Level 1)**

Compliance Area [Part B – Board of Directors& Board Committees]		Auditor Remarks/ Observations
	1. Whether members of the Board meet the competency and appointment criteria set by the Government, Companies Act and governing rules of the PSU/ company? 2. Whether the 'chairman' and 'managing director'/CEO function is separated? 3. Whether there is a clear bifurcation of responsibility between a chairman and a CEO? 4. Are the independent directors at least one-third of total number of directors? 5. Whether the Board of Directors has a code, charter, responsibility and accountability statement? 6. Whether there is transparent and effective communication with stakeholders on both positive and negative aspects of the business? 7. Whether there is a stakeholder engagement policy to determine positive and negative news about the company on a timely basis? 8. Whether the Board of Directors have reviewed the annual and quarterly operating performance of the company? Whether the Board of Directors have prepared and made periodical/ annual disclosuresas required by the Board especially the annual report disclosures? 9. Whether the company has designed and implemented an internal control system for control over financial reporting? Does the system function effectively? Is the Audit Committee and the Board satisfied with the internal financial controls? 10. Whether the performance of the board and individual directors is assessed annually and disclosure regarding the same is made in the annual report? 11. Whether the Board has identified Directors who are responsible for reviewing the performance and financial affairs of the step down subsidiaries, associated companies and joint ventures/ public private partnership projects? 12. Whether identified Directors who are deputed to review the affairs of the subsidiary companies submitted their annual assessments to the main Board for consideration, decision making and public disclosures? 13. Whether the Board has constituted all the mandatory and non-mandatory Board Committees to deal with various	

aspects of Board matters?

14. Whether the Board/ Audit Committee has reviewed and monitored the auditor’s independence and performance, and Effectiveness of audit process?

15. Whether the Board has disclosed a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any which in the opinion of the Board may threaten the existence of the company?

16. Over the last 12 months, did the Board and Audit Committee meet at least 4 times without exceeding the time gap of three months between two meetings?

17. Does the Number of independent directors on the Audit Committee comply with the statutory requirement?

18. Whether the Chairman of the Audit Committee is an independent director?

19. Does the audit committee have clear and written terms of reference? Are the terms of reference reviewed periodically? If yes, how often?

20. Whether members of the Audit Committee are financially literate and have the ability to read and understand the financial statements?

21. Do all members of the Audit Committee have knowledge of financial matters of the company and at least one member has expertise in accounting and financial management?

22. Do the procedures governing the Audit Committee specify that the Audit Committee is responsible for reviewing with the management the performance of statutory and internal auditors-and adequacy of the financial disclosures and internal control systems?

23. Has the Audit Committee reviewed the adequacy of the internal audit function of the company during the year?

24. The Board/ Audit Committee to review the functioning of the Whistle Blower mechanism, whether this has been accomplished?

25. Whether related party transactions are periodically placed in the audit committee?

26. Whether the Board/ Audit Committee has reviewed the integrated risk management policy and risk mitigating action plans?

27. Whether the Board/ Audit Committee has reviewed the impact of continuing internal control deficiencies? Whether there are any significant deficiencies or financial/ non-

	financial irregularities/ frauds that have an impact on the financial statements of the company? 28. Whether all material transactions with related parties not forming a normal course of business are placed before the audit committee? 29. Whether all material details of transaction with related parties or other which are not an arm's length basis along with justifications placed before the audit committee? 30. Whether the executive team, key personnel and auditors have made prescribed disclosures of the related party transactions? 31. Whether the company trains its Board members in the business model of the company as well as the risk profile of the business parameters of the company, their responsibilities as directors, and the best ways to discharge them?	

Compliance Area **[Part B – Board of Directors& Board Committees]**	**Summary Opinion of Auditor** **[Descriptive narration of areas of improvement]**
Overall Audit Rating: • **Excellent (Level 5)** • **Good (Level 4)** • **Satisfactory (Level 3)** • **Poor (Level 2)** • **Unacceptable (Level 1)**	

Compliance Area [Part C – Disclosures & Transparency]		Auditor Remarks/ Observations
1. Whether the company has made comprehensive disclosures about its code of conduct, recruitment, procurement/ tendering, customer charters and other important policy disclosures on its website? 2. Whether there exist institutional mechanisms for disclosing positive and negative information of the company to all stakeholders on a timely basis? 3. Do the company's accounting procedures comply with the Accounting Standards adopted by National Financial Reporting Authority/ICAI/ C & AG? 4. Is the deviation from the prescribed Accounting Standards disclosed and explained in the financial statements and in the corporate governance report of the company? 5. All disagreements on financial reporting between the company/ Board and auditors have been appropriately disclosed in the financial disclosures? 6. All material non-financial information and business segment wise information has been disclosed? 7. Does a "Management Discussion and Analysis" form part of the director's report to the shareholders. ? 8. Whether segment-wise and product-wise performance analysis is done and strengths and weaknesses identified adequately? 9. Whether comparative study is made to measure financial performance with respect to operational performance? 10. Whether all disclosures pertaining to personal interest leading to potential conflict with the interest of company are made? 11. Whether any significant threat to the "going concern" status of the company/ PSU has been disclosed? 12. Whether all material liabilities/ legal disputes and contingent liabilities have been appropriately disclosed? 13. Whether all concentration risks have been suitably disclosed? 14. A half-yearly declaration of financial performance including summary of the significant events in last six-months, may be sent to each household of shareholders. 15. Does the company's latest Annual Report have a separate section on Compliance to Corporate Governance Guidelines		

	issued by DPE? 16. Does the Annual Report disclose adequately noncompliance of any mandatory requirements with reasons? 17. Does the-company produce periodic-reports-and-press releases to indicate significant developments impaction-on corporate governance (such as legal and-environmental issues, commitment to workforce, suppliers, Customers And-local communities etc.?	

Compliance Area [Part C – Disclosures & Transparency]	Summary Opinion of Auditor [Descriptive narration of areas of improvement]
	Overall Audit Rating: • **Excellent (Level 5)** • **Good (Level 4)** • **Satisfactory (Level 3)** • **Poor (Level 2)** • **Unacceptable (Level 1)**

Compliance Area [Part D – Accountability]		Auditor Remarks/ Observations
	1. Whether there are clearly defined job roles, duties, responsibilities and a clear delegation of authority/ power matrix? 2. Whether there is minimization of discretionary powers at every level and if the discretionary power is revoked full justification is noted? 3. Whether the human resources reporting system, hierarchy system and line staff function are clearly defined? 4. Whether there is performance appraisal mechanism to measure the budgeted performance versus actual performance? 5. Whether there is a well-defined succession policy for the selection of senior level management personnel? 6. Whether there is any delay in finalization of financial statements and if delayed who is accountable for it? 7. Whether there is a delay in finalization of accounts leading to arrears of accounts and if so whether the same is included in the Directors Report? 8. Whether the Board of Directors are made personally liable for non-preparation of Annual Financial Statements? 9. Whether any unviable projects are taken up without proper feasibility and analysis? 10. Whether project appraisals are outsourced to third parties and decisions are taken based on their recommendations? Is there a situation where the project fails, accountability is on the third party appraiser and not of the management? 11. Whether there are instances where delegations of power have been exceeded/ superseded? 12. Whether there are any instances of incorrect decisions leading to financial losses and whether the persons were accountable for the same? 13. Whether accountability is fixed for the directors who have been appointed to attend Board meetings of Joint venture partners in case of Public Private Partnership projects? 14. Whether there are instances of post facto modifications	

	of decisions impacting financial statements/ material tenders and the reasons for the change in the decision are recorded? 15. Whether there is a check on agreements with related parties and whether there is adequate disclosure of related party transactions? 16. Whether the recommendations given by audit committee are implemented in time? 17. Whether there is a review by the Board of the implementation effectiveness of the recommendations of the Audit Committee/ Risk Management Committee/ other committees? 18. Whether the accountability is fixed and action taken for non-achievement of targets/ budgeted performance? 19. Whether disciplinary cases are completed in time and process is reviewed by the Board? Whether there is clear identification of cases to be brought to Board for approval? 20. Whether there is timely execution of projects including payments to vendor/contractors and quick decision making in project execution? 21. Whether procurement of good and service is at a comparatively reasonable cost? 22. Whether there is transparency in the decision making process? 23. Whether fraud and bribery risks are identified and there are anit-bribery mechanisms in place to deal with corruption and related practices? **24.** Whether the top level posts like CMD, Chairman, and Independent Directors are filled up on a timely basis? 25. Whether there is timely payment to the contractors or is there any intentional delay in making payments? 26. Whether there is any undue influence from politically exposed persons, members of legislature/ parliament or local bodies? 27. Whether there is timely finalization of contracts? 28. Whether there is an independent review of high value contracts by an independent agency with the organization other than the people responsible for finalizing the contract excluding internal auditors? 29. Whether Central/State Government enterprises have given guarantee/counter guarantee for the finance raised by private contractors or third parties?	

	30. Whether the appointment, transfer, promotion of various levels is done in more transparent and consistent way? 31. Whether there are any post bid advantages to the party? 32. Whether the absence of directors in important decision making meetings is duly approved by the Chairman of the meeting? 33. Whether there is delay in the tendering process with a view to award the high value contract to a particular party? 34. Whether any favor is made to the contractor by going in for retendering without a valid justification? 35. Whether any contractual terms are overlooked to favor a particular party to the contract? 36. Whether the pricing policy of any commodity is comparable to the market price of similar commodity? 37. Whether the tender procedures for all high value contracts are documented and publicized? 38. Whether the movable property and immovable property returns of Key Management Personnel are published/made available on website? 39. Whether the Board reviews that relatives/close family members of Key Management Personnel/Board Members are not associated with PSU's activities?	

Compliance Area **[Part D – Accountability]**	**Summary Opinion of Auditor** **[Descriptive narration of areas of improvement]**
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Overall Audit Rating: • **Excellent (Level 5)** • **Good (Level 4)** • **Satisfactory (Level 3)** • **Poor (Level 2)** • **Unacceptable (Level 1)**	

Compliance Area [Part E – Others]		Auditor Remarks/ Observations
1. Does the Board of Subsidiary company include at least one independent Director of the holding company as a director? 2. Verify if the Report of the Board of Directors of the holding Company includes a statement to the effect that the directors have reviewed the statement of all significant transactions and arrangements entered into by the unlisted subsidiary Company. 3. Whether statement of all significant transactions of subsidiary company reviewed periodically? 4. Whether all policies, processes or procedures of holding company adopted and implemented by subsidiary company are approved and disclosed by the subsidiary company? 5. At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of a material non listed Indian subsidiary company. 6. The Audit Committee of the listed holding company shall also review the financial statements, in particular, the investments made by the unlisted subsidiary company. 7. The minutes of the Board meetings of the unlisted subsidiary company shall be placed at the Board meeting of the listed holding company. The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company. 8. Does the company'slatest Annual Report disclose all pecuniary relationship or transactions of the part-time director's vis-à-vis the company? 9. Whether the criteria of making payments to non-executiveDirectors and convertible instruments held by them are disclosed in its annual report? 10. Whether remuneration details of directors forms a part of the section on the corporate governance of the Annual Report? 11. Does the company disclose in its latest Annual Report the details on Remuneration of Directors? 12. Whether the remuneration is determined in accordance with the policy put to shareholders? 13. Whether the remuneration of Directors and senior executives is disclosed in the remuneration report?		

	14. Whether the shareholders have approved the remuneration policy in the AGM? 15. The company may establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization. 16. Whether all conditions of corporate governance are complied with? 17. Does the directors Report include compliance certificate obtained from auditor or secretary?	

Compliance Area **[Part E – Others]**	**Summary Opinion of Auditor** **[Descriptive narration of areas of improvement]**
Overall Audit Rating: • **Excellent (Level 5)** • **Good (Level 4)** • **Satisfactory (Level 3)** • **Poor (Level 2)** • **Unacceptable (Level 1)**	

Additional Information to be sought and commented upon:

A] The details of vacancies on the Board of Directors and their filling up during the year 2012-13 may be furnished in the following format.

Sr. No.	Name of the CPSE	Name of the Post	Date on which vacancy occurred	Date on which vacancy was filled up

B] The details of information to be furnished to the Board:

Sr. No.	Details of information to be furnished to the Board	Whether the information has been furnished to the Board (Y/N)
1.	Annual operating plans and budgets and any updates	
2.	Capital budgets and any updates	
3.	Quarterly results for the company and its operating divisions or business segments	
4.	Minutes of meetings of audit committee and other committees of the Board	
5.	The information on recruitment and remuneration of Senior officers just below the board level, including appointment or removal of Chief Financial Officer and the Company Secretary.	
6.	Show cause, demand, prosecution notices and penalty notices which are materially important.	
7.	Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.	
8.	Any material default in financial obligations to and by the company, or substantial non-payment for goods sold by the company	
9.	Any issue, which involves possible public or product liability claims of substantial nature, including any judgment or order which, may have passed strictures on the conduct of the company or taken an adverse view regarding another enterprise that can have negative implications on the company.	
10.	Details of any joint venture or collaboration agreement.	
11.	Transactions that involve substantial payment towards goodwill, brand equity or intellectual property.	
12.	Significant labour problems and their proposed solutions. Any significant development in Human Resources/Industrial relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc.	
13.	Sale of material nature of investments, subsidiaries, assets	

	which is not in normal course of business.	
14.	Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.	
15.	Non-compliance of any regulatory, statutory nature or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.	
16.	Information to be mandatorily reviewed by the Audit Committee: - Management discussion and analysis of financial condition and results of operations. - Statement of significant related party transactions (as defined by the audit committee), submitted by management - Management letters/letters of internal control weaknesses issued by the statutory auditors - Internal audit reports relating to internal control weaknesses. - The appointment, removal and terms of remuneration of the Chief Internal Auditor shall be subject to review by the Audit Committee.	
17.	Does the audit committee have clear and written terms of reference?	
18.	Are the terms of reference reviewed periodically? If yes, how often?	
19.	Have the members of the Audit Committee been issued appointment.	
20.	Has an annual calendar of meetings of the Audit Committee been prepared for the year 2012-13?	
21.	Has the Chairperson (Independent Director) of the Audit Committee attended the AGM?	
22.	Has the Audit Committee conducted a meeting with the Statutory Auditors without the presence of the Finance Officers/Management of the company during 2012-13?	
23.	Has the Audit Committee held discussion with the Statutory Auditor before commencement of the annual audit for the year 2012-13	
24.	Has the Audit Committee reviewed the adequacy of the internal audit function of the company during the year 2012-13?	
25.	Has the Audit Committee conducted any discussions with the internal auditors during 2012-13	
26.	Does the company have a whistle blower mechanism? If yes, has the audit committee reviewed the mechanism during 2012-13?	
27.	Does the company have anti-fraud and anti-corruption policies and procedures? If yes, have they been reviewed by the Audit Committee during 2012-13?	
28.	Has the Audit Committee reviewed the progress of expansion projects of the company during 2012-13?	
29.	Has an annual report for the year 2012-13 on the working of Audit Committee prepared.	
30.	Does the Audit Committee send regular reports to the Board of Directors? If yes, in 2012-13 how many reports were sent and when (indicate dates)	
31.	Have the Audit Committee members been provided training on emerging changes during the year 2012-13? If no, has the Audit Committee recommended any such training?	

References

- OECD principles on Corporate Governance
- King 3 Code on Corporate Governance website
- Ministry of Corporate Affairs website
- SEBI website
- IFCI Washington website

Acknowledgement

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