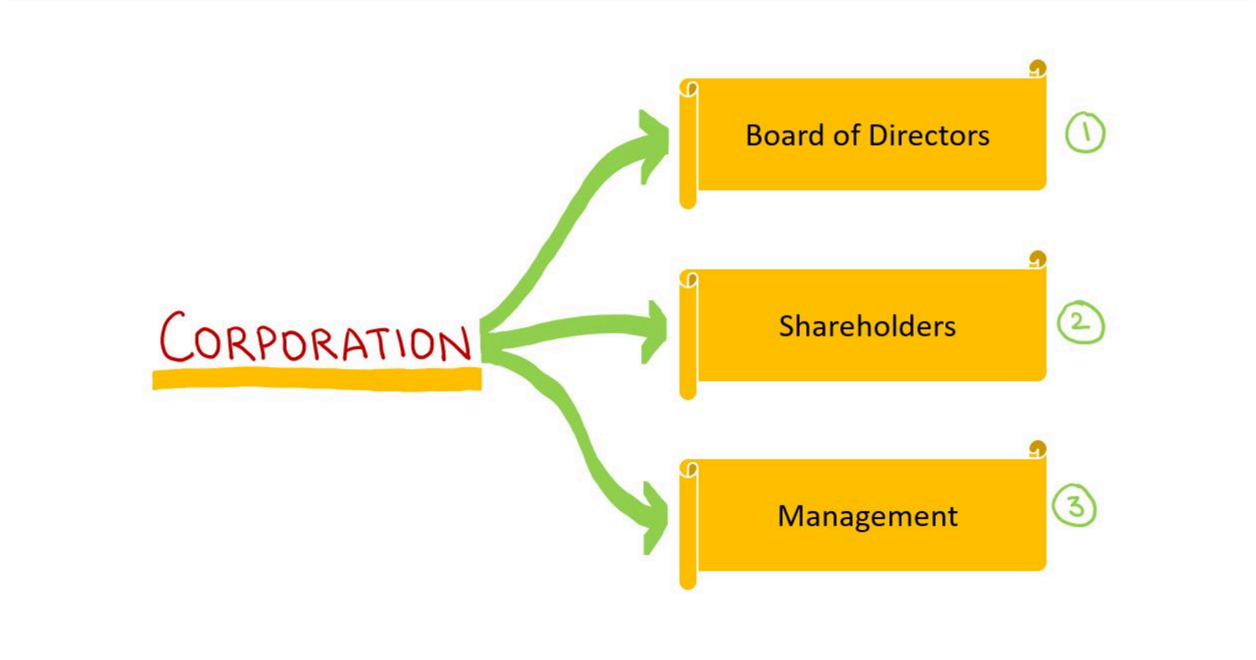
Auditing Course Material

Part 15 of 61 (Chapters 1401-1500)

1. What is Corporate Governance

A **Corporation** is a mechanism established to allow different parties to contribute capital, expertise, and labour for their mutual benefit. The investor/shareholder participates in the profits of the enterprise without taking responsibility for the operations. The management runs the company without being responsible for providing the funds personally. To make this possible, laws have been passed that give shareholders limited liability and, correspondingly, limited involvement in a corporation's activities. That involvement does include, however, the right to elect Directors, who have a legal duty to represent the shareholders and protect their interests.



As representatives of the shareholders, directors have both authority and responsibility to establish basic corporate policies and to ensure that they are followed. The Board of Directors, therefore, has an obligation to approve all decisions that might affect the long-run performance of a corporation.

This implies that the Corporation is fundamentally governed by 3 entities, the **board of directors** overseeing **top management**, with the concurrence of the **shareholders**. There are also external stakeholders like Customers, Suppliers, Creditors, Governments, Unions, Local communities, General public etc.

The term Corporate Governance (CG) refers to the relationship among these external and internal groups in determining the direction and performance of the corporation.

In other words, **Corporate Governance** is how a corporation is administered or controlled. It is a set of processes, customs, policies, laws and instructions affecting the way a corporation is directed, administered or controlled. The participants in the process include employees, suppliers, partners, customers, government, and professional organization regulators, and the communities in which the organization has presence.

The objectives of and need for Corporate Governance are discussed next one by one.

---

1. What is Corporate Governance

Corporate governance serves several crucial objectives:

1. **Accountability**: Ensuring that all stakeholders (shareholders, employees, customers, etc.) have their interests considered and are accountable for their actions within the organization.

2. **Transparency**: Providing clear, accurate, and timely information regarding the company's operations, performance, and financial status to stakeholders.

3. **Ethical Conduct**: Promoting and maintaining high ethical standards throughout the organization, which includes fairness, honesty, and integrity in decision-making and operations.

4. **Risk Management**: Identifying and managing various risks faced by the company, including financial, operational, legal, and reputational risks.

5. **Effective Control**: Establishing mechanisms and procedures to monitor and control the company's operations, ensuring compliance with laws, regulations, and internal policies.

6. **Enhanced Performance**: Improving the company's overall performance and sustainability by aligning strategies, objectives, and activities with stakeholders' interests.

7. **Protection of Stakeholder Interests**: Safeguarding the interests of various stakeholders, such as shareholders, employees, customers, and the community, by ensuring their voices are heard and considered in decision-making processes.

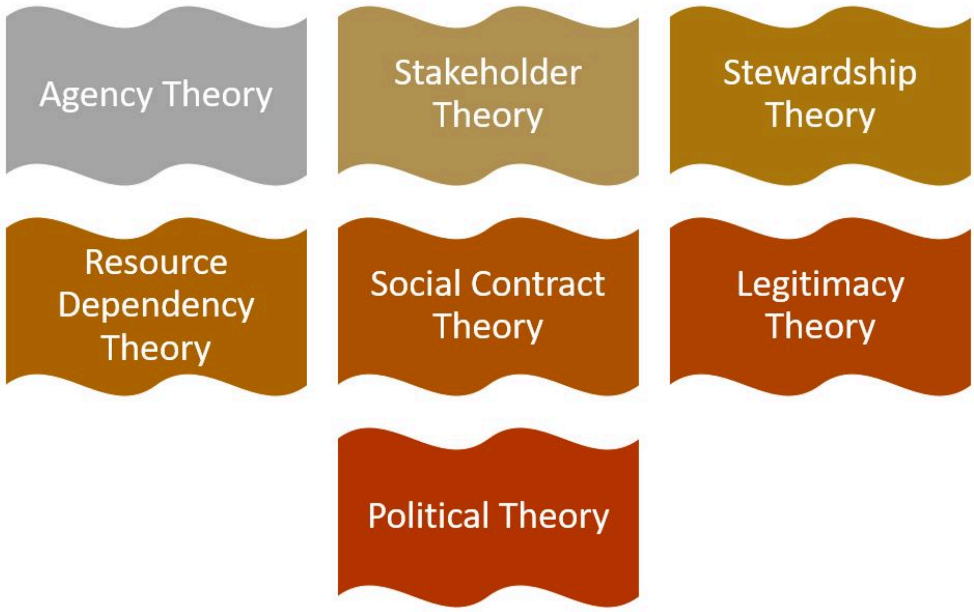
8. **Long-Term Sustainability**: Fostering a corporate culture focused on long-term value creation and sustainability rather than short-term gains.

8. **Board Effectiveness**: Ensuring that the board of directors operates efficiently, independently, and in the best interest of the company and its stakeholders.

9. **Compliance**: Complying with legal and regulatory requirements and adhering to established governance guidelines and best practices.

---

2. Theories of Corporate Governance



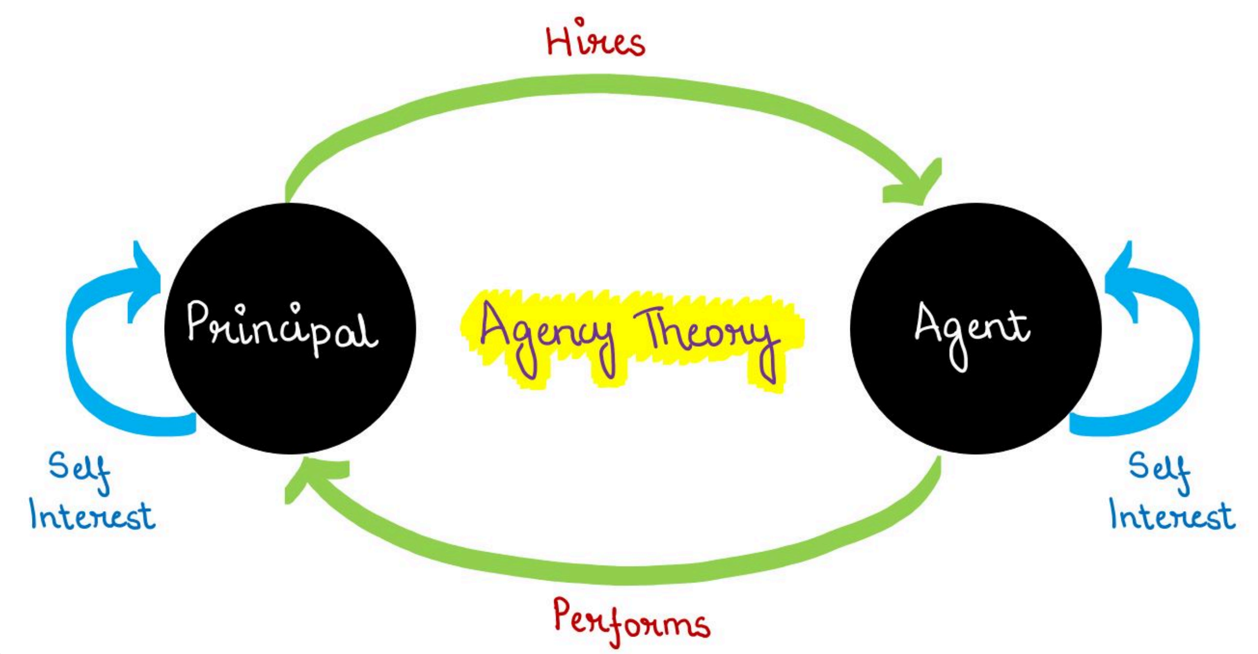
Some of the major theoretical frameworks or theories that can be identified from the corporate governance literature, are given below.

- Agency Theory & its variants
- Stakeholder Theory
- Stewardship Theory
- Resource Dependency Theory
- Social Contract Theory
- Legitimacy Theory
- Political Theory.

These theories are discussed next.

2. Theories of Corporate Governance

Agency theory having its roots in economic theory was exposited by *Alchian* and *Demsetz* (1972) and further developed by *Jensen* and *Meckling* (1976).



Agency theory is defined as "the relationship between the *principals*, (Shareholders) and the *agents* (company's Executives and Managers)". These principals delegate the work of running the business to the Directors or Managers, who are agents of shareholders. The shareholders expect the agents to act and make decisions in the best interest of principal. The theory states that Corporate Executives have a moral and financial duty to act in the best interests of the parties they serve, specifically the shareholders.

The **agency problem** arises because managers will not solely act to maximize the shareholders' wealth; they may protect their own interests or seek the goal of maximizing companies' growth instead of earnings while making decisions. **Agency costs** are arising from divergence of interests between shareholders and company managers. 'Managerial discretion', defined as managers' decision-making latitude, allows managers to serve their own rather than shareholders' objectives, and therefore is likely to be associated negatively with corporate performance. Based on the agency theory, managers will not act to maximize the returns to shareholders unless appropriate governance structures are implemented to safeguard the interests of shareholders, especially in large corporations.

When there are multiple principals—and especially so where they have different interests, or 'heterogeneous preferences', agency costs will be higher. Multiple principals will face coordination costs, which will inhibit their ability to engage in collective action. These in turn will interact with agency problems in two ways. First, difficulties of coordinating between principals will lead them to delegate more of their decision-making to agents. Second, the more difficult it is for principals to coordinate on a single set of goals for the agent, the more obviously difficult it is to ensure that the agent does the 'right' thing. Therefore, it can be concluded that coordination costs as between principals exacerbate the agency problem.

Shareholder theory

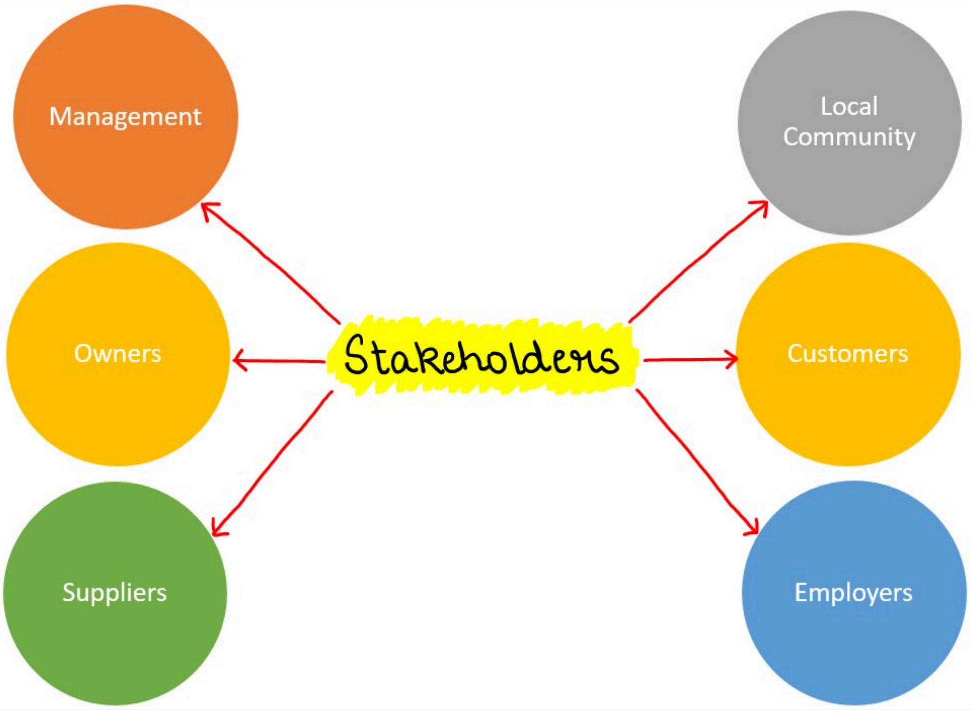
It also important here to understand Shareholder theory, which is a form of Agency theory. The shareholder theory was originally proposed by *Milton Friedman* and it states that the sole responsibility of business is to increase profits for its shareholders. It is based on the premise that Management is hired as the agent of the Shareholders to run the company for their benefit, and therefore they are legally and morally obligated to serve their interests (by maximizing profits).

Transaction Cost theory

Transaction Cost theory is an alternative variant of the Agency theory. It describes governance frameworks as being based on the net effects of internal and external transactions, rather than as contractual relationships outside the firm (i.e. with shareholders). Where Agency theory focuses on the individual agent, transaction cost theory focuses on the individual transaction. Agency theory looks at the tendency of Directors to act in their own best interests, pursuing salary and status. Transaction Cost theory considers that Managers (or Directors) may arrange transactions in an opportunistic way.

2. Theories of Corporate Governance

Stakeholder Theory was embedded in the Management discipline in 1970 and was gradually developed by *Edward Freeman (1984)* incorporating corporate accountability of company's Executives and Managers to a broad range of stakeholders (rather than just shareholders). It states that Managers in organizations have a network of relationships to serve – this includes the suppliers, employees and business partners. The theory focuses on managerial decision-making and interests of all stakeholders, and no sets of interests are assumed to dominate the others.

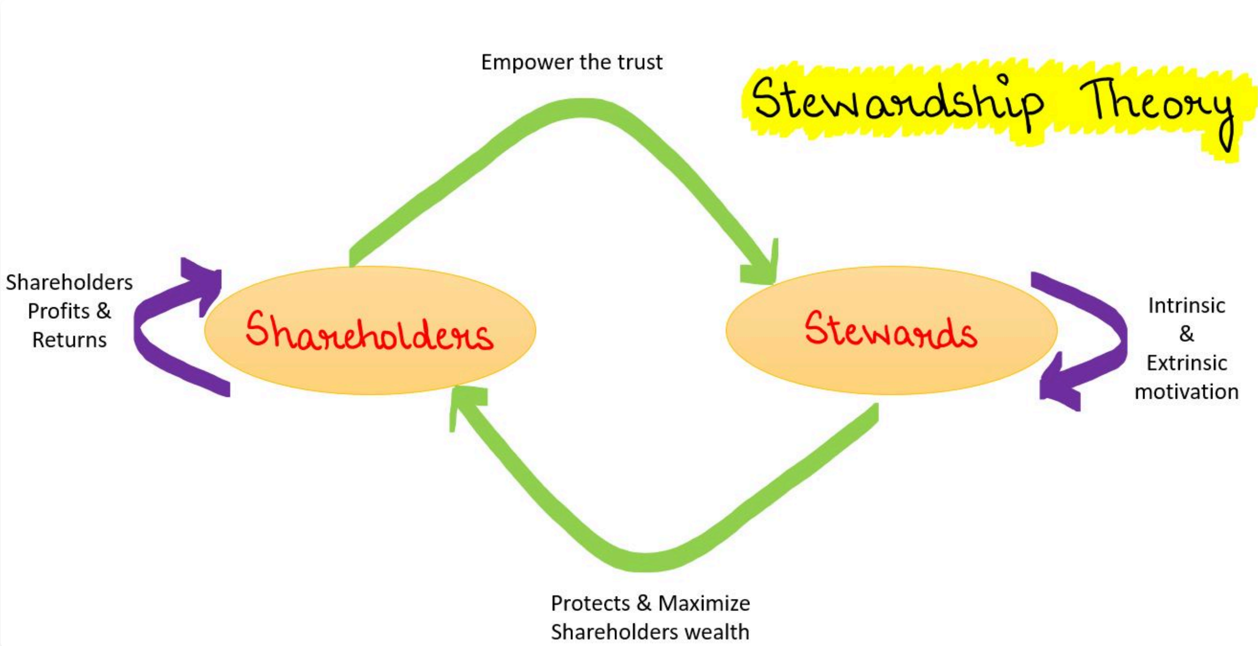


According to R. Edward Freeman, the stakeholder concept was originally defined as including "those groups without whose support the organization would cease to exist."

Stakeholder theory suggests that the purpose of a business is to create as much value as possible for stakeholders. In order to succeed and be sustainable over time, executives must keep the interests of customers, suppliers, employees, communities and shareholders aligned and going in the same direction.

2. Theories of Corporate Governance

Stewardship Theory employs the term 'steward' in the context of a person who oversees and manages another's property or estate. In the corporate sense, managers and employees are seen as guardians entrusted with the responsibility of protecting the corporation's resources, property, and interests in the absence of the owner, acting as caretakers. Their duty is to diligently safeguard the corporation, refraining from using its assets for personal gain.



This theory adopts a social approach to human nature, encouraging managers to manage the corporation as if it were their own. Unlike mere agents, they are positioned as stewards. The motivation for managers comes from aligning with the principal's objectives, fostering a collective, pro-organizational, and trustworthy behavior pattern.

Thus, under this theory, first of all values as standards are identified and formulated. Second step is to develop training programmes that help to achieve excellence. Thirdly, moral support is important to fill any gaps in values.

2. Theories of Corporate Governance

Resource Dependence Theory in corporate governance posits that organizations are reliant on external resources for their functioning and sustainability. It emphasizes the significance of relationships between organizations and their external environment, where the control of resources shapes power dynamics. Managers are focused on addressing external dependencies to secure vital resources and enhance control over these resources.

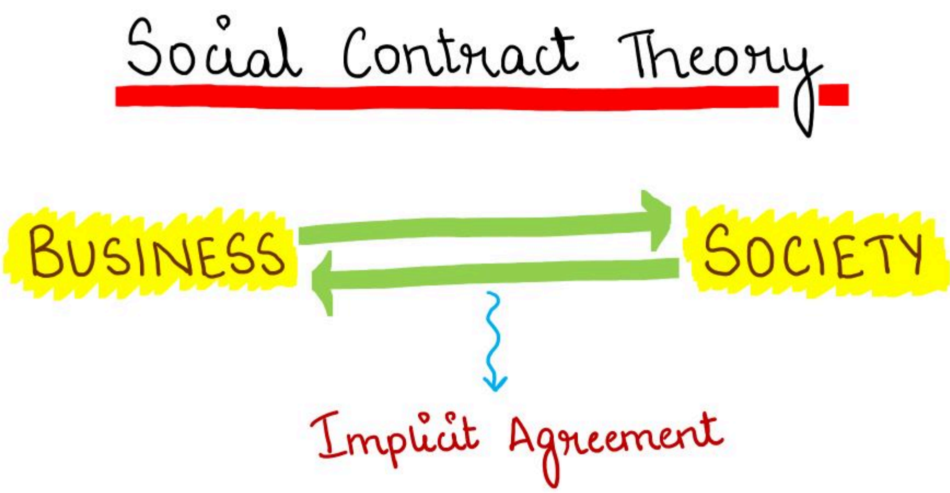
The organizations actively engage with their external environment to secure access to resources essential for their survival. The theory suggests that an organization's competitiveness is contingent upon how effectively they manage their relationships with external resources.

Key premises of Resource Dependence Theory:
1. Organizations respond to external demands from entities controlling crucial resources.
2. Resources, vital for organizations, often originate from the external environment and are controlled by other entities.
3. Resources serve as a source of power, and an organization's dependence on external resources determines power dynamics.
4. Interactions and dependencies between organizations are critical for resource acquisition.
5. Power relationships are multifaceted, relational, and situational.
6. Managers aim to manage external dependencies to ensure organizational survival, autonomy, and resource acquisition.

In essence, Resource Dependence Theory highlights the interdependence of organizations on external resources and how they strategically navigate relationships with external entities to secure these resources, thereby influencing power dynamics and organizational behavior.

For example, a technology company's reliance on a specific software provider for essential applications highlights resource dependence. The company's operational decisions and strategies might aim to secure consistent access to these software resources, ensuring stability and functionality within its operations.

2. Theories of Corporate Governance



The Social Contract Theory in corporate governance revolves around the idea that businesses hold an implicit agreement with society. According to this theory, organizations have an obligation to conduct themselves in a manner aligned with societal expectations, norms, and ethical standards. This suggests a reciprocal relationship where society supports and engages with companies as long as they operate ethically and fulfill their societal responsibilities.

For example, a multinational corporation promising eco-friendly manufacturing practices but failing to deliver might face public backlash and protests, resulting in reduced consumer trust and decreased market share. This highlights how breaching societal expectations can break the implicit social contract, leading to severe consequences for the company's reputation and success.

2. Theories of Corporate Governance

Legitimacy theory is defined as “a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate with some socially constructed systems of norms, values, beliefs and definitions”. Similar to Social Contract theory, Legitimacy theory is based upon the notion that there is a social contract between the society and an organisation. A firm receives permission to operate from the society and is ultimately accountable to the society for how it operates and what it does, because society provides Corporations the authority to own and use natural resources and to hire employees.

Traditionally, profit maximization was viewed as a measure of corporate performance. But according to the Legitimacy theory, profit is viewed as an all-inclusive measure of organizational legitimacy. The emphasis of Legitimacy theory is that an organization must consider the rights of the public at large, not merely the rights of the investors. Failure to comply with societal expectations may result in sanctions being imposed in the form of restrictions on the firm's operations, resources and demand for its products.

In other words, the concept suggests that if society perceives that an entity has violated its social contract or breached accepted norms, the legitimacy of that entity is at risk. Thus, legitimacy theory underscores the importance for organizations to align their values with societal norms to maintain positive perceptions and legitimacy in the eyes of the broader community.

Social Contract Theory vis-a-vis Legitimacy Theory

Social contract theory centers around the idea of a contractual agreement between organizations and society, where both parties have ethical responsibilities and expectations, and threats arise if these are not fulfilled. On the other hand, legitimacy theory focuses on organizations continuously aligning their values and actions with societal norms to maintain perceived acceptability. It sees threats to legitimacy when there is a disparity between organizational values and societal expectations, emphasizing the ongoing efforts of organizations to secure positive perceptions over time.

---

2. Theories of Corporate Governance

The political theory of corporate governance revolves around the intricate relationship between a country's political landscape and the shaping of its corporate governance systems. It asserts that the way corporations are governed cannot be separated from the political context of a nation. Political forces wield considerable influence, significantly molding the structure, functioning, and evolution of governance frameworks within companies.

In essence, this theory emphasizes that corporate governance doesn't exist in isolation but is deeply intertwined with the broader political structures of a country. It encompasses various aspects like the ownership patterns of firms and the prevailing political ideologies, all of which are deeply rooted within national boundaries.

In politically constrained environments, economic efficiency alone is considered a weak force for driving corporate governance changes. The theory suggests that any attempt to reform corporate governance without addressing the underlying political determinants may result in negative outcomes. In other words, the compatibility between a new corporate governance structure and the entrenched political framework is essential for successful reforms.

An illustrative example of the political theory is the case of the United States. The traditional policies in the U.S. aimed at limiting the concentration of power and ownership within financial institutions have significantly influenced the development of a dispersed ownership structure. This, in turn, has shaped a fundamental feature of U.S. corporate governance—the separation of ownership and control.

3. Global Practices in Corporate Governance

Over the years, the issue of Corporate Governance has received a high level of attention. There are several reports and recommendations of the International Committees/Associations, etc. on the development of appropriate framework for promoting good Corporate Governance standards, codes and practices to be followed globally.

Some of the important ones are discussed next.

3. Global Practices in Corporate Governance

Some of the prominent Committees on Corporate Governance worlwide are given below.

Cadbury Committee Report on Corporate Governance in UK (1992)

The Cadbury Committee addressed the financial aspects of corporate governance and subsequently produced a code of best practice which all boards of the UK listed companies should comply with.

Vienot Report in France (1995)

The Vienot Report led to the recommendation of elimination of cross shareholdings where companies hold shares in each other and directors sit on each other board leading to possible compromising of respective interests.

Netherlands' Peters Committee Report (1997)

The recommendations of the Peters Committee heralded a fundamental overhaul of Dutch corporate law to restore the position of shareholders, through a combination of changes in the Dutch Civil Code (DCC), containing the Companies Act, Corporate Governance Code etc.

Hampel Committee Report on Corporate Governance (1998)

The focus of Hampel Committee was on the establishment of Audit Committee of at least 3 non-executive directors.

King Committee on Corporate Governance in South Africa (2002)

The committee gave recommendations like: Companies should have a unitary board structure; An external audit provides an independent and objective check on the way in which the financial statements have been prepared and presented by the directors.

Higgs Report

Higgs Report (Review of the role and effectiveness of Non-Executive Directors), 2003 discussed the role of non-executive directors. Boards should comprise of at least one-third non-executive directors, a majority of whom should be independent.

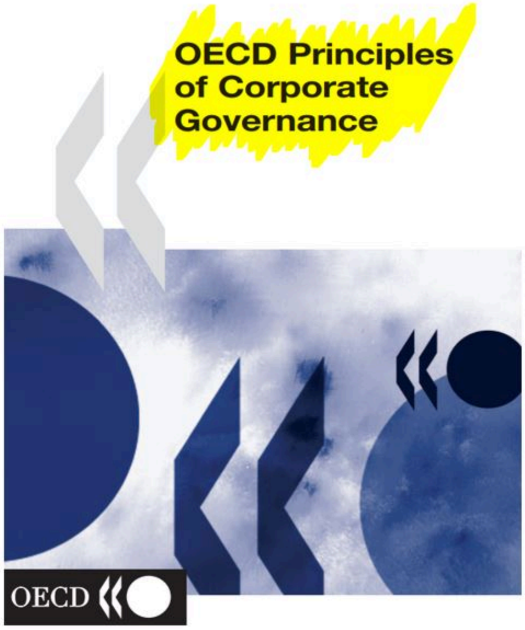
3. Global Practices in Corporate Governance

The Sarbanes Oxley Act, 2002 (SOX) is one of the most important Acts for promoting good Corporate Governance standards. The Sarbanes-Oxley Act was passed by Congress to curb widespread fraudulence in corporate financial reports and scandals that rocked the early 2000s.

Some of the important features of Sarbanes Oxley Act are as follows:

- SOX **cracks down on corporate fraud**. It banned company loans to executives and gave job protection to whistleblowers. SOX protects employees that report fraud and testify in court against their employers. Companies are not allowed to change the terms and conditions of their employment. They cannot reprimand, fire, or blacklist the employee. Whistleblowers can report any corporate retaliation to the Occupational Safety and Health Administration.
- The Act **strengthens the independence and financial literacy of corporate boards.** It holds CEOs personally responsible for errors in accounting audits.
- The most important section of SOX is Section 404 which requires **corporate executives to certify the accuracy of financial statements** personally. Section 404 made managers maintain “adequate internal control structure and procedures for financial reporting." Companies' auditors had to “attest” to these controls and disclose “material weaknesses”.
- SOX created a **new auditor watchdog, the Public Company Accounting Oversight Board (PCAOB)**. It set standards for audit reports. It requires all auditors of public companies to register with them. It prohibits accounting firms from doing business consulting with the companies they are auditing. They can still act as tax consultants.

3. Global Practices in Corporate Governance



OECD (Organization for Economic Cooperation & Development) principles were first published in 1999 and revised in 2004. These principles are widely used as a benchmark for policy makers, investors, corporations and other stakeholders.

The OECD principles cover the following issues:

1. Ensuring basis for effective corporate governance framework

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

2. Rights of shareholders and key ownership functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

3. Equitable treatment of shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

4. Role of stakeholders in corporate governance

The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

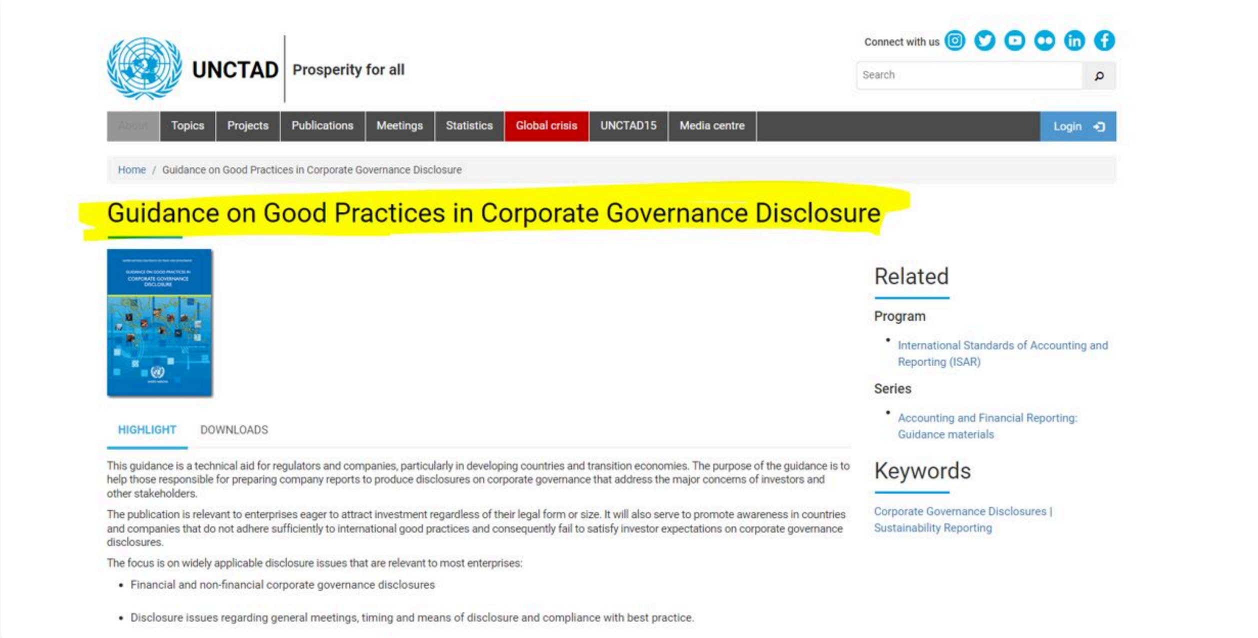
5. Disclosure and transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

6. Responsibilities of the Board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

3. Global Practices in Corporate Governance



United Nations Conference on Trade and Development (UNCTAD) Guidance on Good Practices in Corporate Governance Disclosure (2006) are principles for financial as well as non-financial disclosures.

This guidance is a technical aid for regulators and companies, particularly in developing countries and transition economies. The purpose of the guidance is to help those responsible for preparing company reports to produce disclosures on corporate governance that address the major concerns of investors and other stakeholders.

Accordingly, the enterprises should disclose their financial and operating results. Enterprises should fully disclose significant transactions with related parties. The beneficiary ownership structure should be fully disclosed to all interested parties. Changes in the shareholdings of substantial investors should be disclosed to the market as soon as a company becomes aware of them.

3. Global Practices in Corporate Governance

CAUX ROUND TABLE
FOR MORAL CAPITALISM

The Caux Round Table is an international organization of senior business Executives aiming to promote ethical business practice. It was founded in 1986 by Frits Philips, President of Philips, and Olivier Giscard d'Estaing, along with Ryuzaburo Kaku, President of Canon.

The Caux Round Table (CRT) Principles for Responsible Business set forth ethical norms for acceptable businesses behaviour. The principles are rooted in 3 ethical foundations for responsible business and for a fair and functioning society more generally, namely: responsible stewardship; living and working for mutual advantage; and the respect and protection of human dignity.

The Caux Round Table's approach to responsible business consists of 7 core principles as given below.

Principle 1 - Respect Stakeholders beyond Shareholders

Principle 2 - Contribute to Economic, Social and Environmental Development

Principle 3 - Respect the Letter and the Spirit of the Law

Principle 4 - Respect Rules and Conventions

Principle 5 - Support Responsible Globalization

Principle 6 - Respect the Environment

Principle 7 - Avoid Illicit Activities.

3. Global Practices in Corporate Governance

The Global Reporting Initiative (GRI) is an international independent standard organization (NGO) that helps businesses, Governments and other organizations understand and communicate their impacts on issues such as climate change, human rights and corruption. It was founded in 1997.

These recommendations and principles have been mainly focused on structure of the company, financial and non-financial disclosures, compliance with codes of Corporate Governance, competitive remuneration policy, shareholders' rights and responsibilities, financial reporting and internal controls, etc. All these efforts at international level, in turn, helps to bring favourable changes in the operating systems of Board of Directors, Company's Management and Administration; as well as improve face of relationship between supervisory and executive bodies.

3. Global Practices in Corporate Governance

The United Nations Global Compact, also known as Compact or UNGC, is a United Nations initiative to encourage businesses worldwide to adopt sustainable and socially responsible policies, and to report on their implementation. The Global Compact is a principle-based framework for businesses, stating 10 principles in the areas of human rights, labour, the environment and anti-corruption. Under the Global Compact, companies are brought together with UN agencies, labour groups and civil society.

The Global Compact was officially launched at UN Headquarters in New York on July 26, 2000.

The 10 Principles of the United Nations Global Compact are derived from: the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

These principles are given below.

Human Rights

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and

Principle 2: make sure that they are not complicit in human rights abuses.

Labour

Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

Principle 4: the elimination of all forms of forced and compulsory labour;

Principle 5: the effective abolition of child labour; and

Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment

Principle 7: Businesses should support a precautionary approach to environmental challenges;

Principle 8: undertake initiatives to promote greater environmental responsibility; and

Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

4. Indian Initiatives

The organizational framework for Corporate Governance initiatives in India consists of the **Ministry of Corporate Affairs (MCA)** and the **Securities and Exchange Board of India (SEBI).**

Some of the major corporate governance initiatives taken since 1990s by the corporate bodies and the Government of India are listed below.

- The Confederation of Indian Industry (CII) Code (1998)
- The Kumar Mangalam Birla Committee (2000)
- The Report of Task Force On Corporate Excellence (2000)
- RBI Advisory Group On Corporate Governance (2001)
- RBI Consultative Group Of Directors Of Banks/ Financial Institutions (2002)
- The Naresh Chandra Committee (2002)
- The Narayana Murthy Committee (2003)
- The J.J. Irani Committee (2005)
- Central Coordination And Monitoring Committee
- ICSI Recommendations To Strengthen Corporate Governance Framework (2010)
- Shri Adi Godrej Committee (2012)
- The Companies Act, 2013
- Enabling Transparency (Sec. 120)
- Corporate Social Responsibility (Sec. 135)
- Appointment of Auditors (Sec. 139) and not to render certain services (Sec. 144)
- Structure of Board of Directors (Sec. 149)
- Duties of Directors (Sec. 166)
- Code for Independent Directors (Schedule IV)
- Structure of Audit Committee and its functions (Sec. 177)
- Prohibition on Insider Trading of Securities (Sec. 195)
- Appointment of Key Managerial Personnel (KMP) (Sec. 203)
- Secretarial Audit for Bigger Companies (Sec. 204)
- Defined functions of Company Secretary (Sec. 205)
- Establishment of Serious Fraud Investigation Office (Sec. 211 and 212)
- SEBI Guidelines, 2014
- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
- Board Composition
- Audit Committee
- Nomination And Remuneration Committee

These are discussed next briefly.

4. Indian Initiatives

The major initiatives of Ministry of Corporate Affairs in the sphere of Corporate Governance are discussed below.

Code of Corporate Governance

One of the first such endeavors as a process of restructuring the Corporate Governance framework was in the form of development of a Code of Corporate Governance by Confederation of Indian Industry (CII). In December 1995, CII set up a task force, under the Chairmanship of Mr. Rahul Bajaj, to design a voluntary code of Corporate Governance. In April 1998, the code was released. It was called "Desirable Corporate Governance: A Code" – April 1998.

Naresh Chandra Committee

The Department of Corporate Affairs (now a separate ministry as Ministry of Corporate Affairs) had appointed Naresh Chandra Committee on Corporate Audit and Governance in 2002 in order to examine various Corporate Governance issues. It made recommendations in 2 key aspects of Corporate Governance: financial and non-financial disclosures and independent auditing & Board oversight of Management.

National Foundation for Corporate Governance

The Department had also set up a National Foundation for Corporate Governance (NFCG) in 2003 in association with the CII, ICAI (Institute of Chartered Accountants of India) and ICSI (Institute of Company Secretaries of India) as a not-for-profit trust to provide a platform to deliberate on issues relating to good Corporate Governance.

National Guidelines on Responsible Business Conduct

In March 2019, the Ministry of Corporate Affairs revised the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 (NVGs) and formulated the National Guidelines on Responsible Business Conduct (NGRBC).

The Guidelines provide the following Principles.

1. Businesses should conduct and govern themselves with integrity in a manner that is Ethical, Transparent and Accountable.
2. Businesses should provide goods and services in a manner that is sustainable and safe.
3. Businesses should respect and promote the well-being of all employees, including those in their value chains.
4. Businesses should respect the interests of and be responsive to all their stakeholders.
5. Businesses should respect and promote human rights.
6. Businesses should respect and make efforts to protect and restore the environment.
7. Businesses, when engaging in influencing public and regulatory policy, should do so in a manner that is responsible and transparent.
8. Businesses should promote inclusive growth and equitable development.

9. Businesses should engage with and provide value to their consumers in a responsible manner.

Committee on Business Responsibility Reporting

In furtherance to updation of NVGs and formulation of the NGRBCs, the Ministry of Corporate Affairs has constituted the Committee on Business Responsibility Reporting (BRR) to develop BRR formats for listed and unlisted companies. Non-financial reporting is increasingly forming the basis for enhancing investor confidence in businesses and increasing their creditworthiness. The Committee is to develop comprehensive yet simple formats situating the various stakeholders at the center so as to not increase or duplicate reporting burden. The proposed formats are to reflect linkages to prevalent non-financial reporting formats, viz., Global Reporting Initiative (GRI), Integrated Reporting (IR) etc., and SDGs from a NGRBC perspective.

National Action Plan on Business & Human Rights

The Ministry of Corporate Affairs (MCA) is also in the process of developing India's National Action Plan on Business & Human Rights (NAP) in consultation with various Ministries and State Governments. In February 2019, the MCA published a draft NAP on Business and Human Rights known as 'Zero Draft'. The Zero Draft is primarily a listing of relevant existing legislations and policies categorized under the 3 pillars outlined in the UN Guiding Principles for Business and Human Rights (UNGPs): protect, respect and remedy. The final NAP is still not framed yet.

Corporate Governance – Voluntary Guidelines 2009

The Corporate Governance – Voluntary Guidelines 2009, have been proposed for voluntary adoption by the Corporate Sector of Public Companies and possibly by large private companies. The Guidelines have taken into account the recommendations of the Task Force set up by CII under Chairmanship of Naresh Chandra in February, 2009 to recommend ways to further improve Corporate Governance standards and practices. The recommendations of this Task Force were placed on the Ministry's website for wide stakeholders consultations.

Adi Godrej Committee

In 2012, the Ministry of Corporate Affairs (MCA) constituted a Committee to formulate a Policy Document on Corporate Governance under the Chairmanship of Adi Godrej. The Policy Document sought to synthesize the disparate elements in the diverse guidelines, draw on innovative best practices adopted by specific companies, incorporate current international trends and anticipate emerging demands on Corporate Governance in enterprises in various classes and scale of operations.

Corporate Laws

The important legislations for regulating the entire corporate structure and for dealing with various aspects of governance in companies are Companies Act, 1956 and Companies Act, 2013. These laws have been introduced and amended, from time to time, to bring more transparency and accountability in the provisions of Corporate Governance. That is, corporate laws have been simplified so that they are amenable to clear interpretation and provide a framework that would facilitate faster economic growth.

In 2013, the Companies Act, 2013 was enacted which envisaged radical changes in the sphere of Corporate Governance in India. It provided a major overhaul in Corporate Governance norms and would have far-reaching implications on the manner in which a corporate operates in India in coming times. The Companies (Amendment) Act, 2017 consisting of 93 amendments to the 2013 Companies Act, further resulted in changes related to legal definitions (related party, subsidiary company, associate company, independent Directors, etc.), Corporate Governance (for example, ratification of auditors' appointment and role of audit committee) and Management compliance. It impacts different aspects of business Management in India, including key structuring, disclosure, and compliance requirements.

In addition, the Securities Contracts (Regulation) Act, 1956, Securities and Exchange Board of India Act, 1992 and Depositories Act, 1996 have been introduced, with a view to protect the interests of investors in the securities markets as well as to maintain the standards of Corporate Governance in the country.

J. J. Irani Expert Committee

In 2004, the Government of India constituted an expert Committee under the Chairmanship of Dr. J. J. Irani, the then Director of Tata Sons, to review and make recommendations on Company Law.

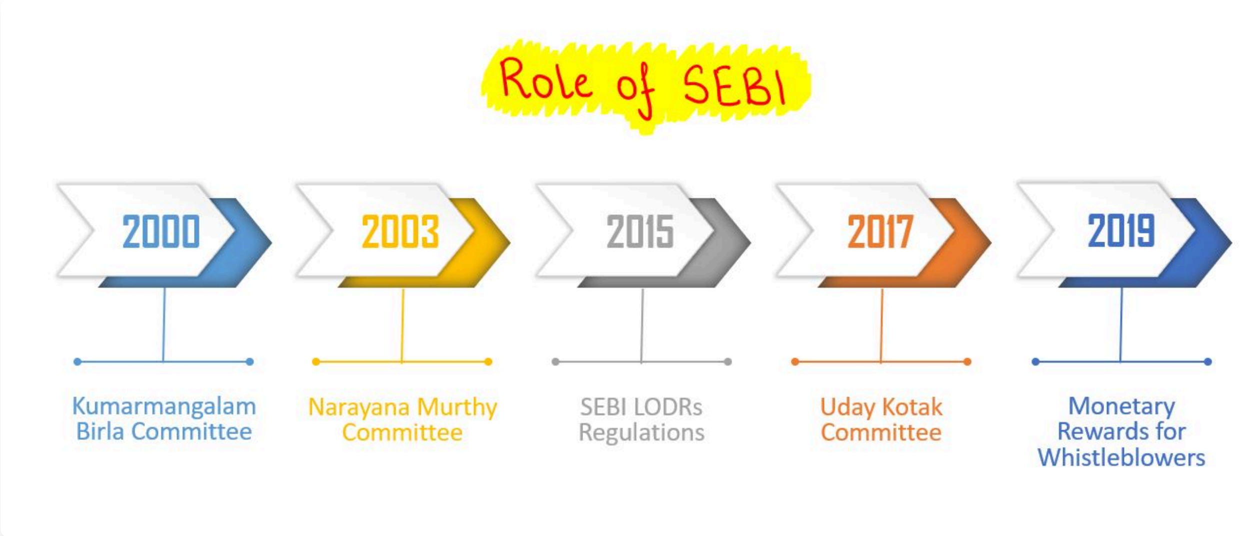
Corporate Governance in Banks

The Banking Regulation Act, 1949, Foreign Exchange Management Act (FEMA), 1999, Payment and Settlement Systems Act, 2007, Companies Act, 2013 and other directives/ regulations/ guidelines/ instructions issued by RBI and SEBI from time to time have created a positive environment and future scope for enhancing corporate governance in banks. Another global initiative in 1999 of the Basel Committee also brought important principles on corporate governance for banks.

RBI constituted an advisory Group headed by Dr. R. H. Patil in 2001. The recommendations of this Group, covered some more codes and principles of private sector companies including consolidation of accounts incorporating performance of subsidiaries, criteria of Independent Directors and disclosures. The Committee was known as the "Standing Committee on International Financial Standard Codes: Advisory Group of Corporate Governance".

To introduce Corporate Governance practices in the banking sector, a working group of Directors of Banks and Financial Institutions was set up. The group named Ganguly Committee submitted its report in 2002.

4. Indian Initiatives



The major initiatives of Securities and Exchange Board of India (SEBI) in the realm of Corporate Governance are discussed below.

Kumarmangalam Birla Committee

The first formal regulatory framework for listed companies specifically for Corporate Governance was established by the SEBI in February 2000, following the recommendations of Kumarmangalam Birla Committee Report. The recommendations of the Report, led to an inclusion of Clause 49 in the Listing Agreement in the year 2000.

Narayana Murthy Committee

SEBI had also set up another Committee in 2003 under the Chairmanship of N. R. Narayana Murthy, to review Clause 49, and suggest measures to improve Corporate Governance standards. Some of the major recommendations of the Committee primarily related to audit committees, audit reports, independent Directors, related party transactions, risk management, directorships and Director compensation, codes of conduct and financial disclosures.

SEBI LODRs Regulations, 2015

In 2015, with a view to consolidate and streamline the provisions of existing listing agreements for different segments of the capital market and the provisions pertaining to listed entities with the Companies Act, 2013, the SEBI notified Listing Obligations and Disclosure Requirements (LODRs) Regulations, 2015 for the listed entities. The Regulations prescribes corporate governance provisions for selected entities.

Uday Kotak Committee

The SEBI formed 21-member Committee on Corporate Governance headed by banker Uday Kotak, which submitted its report to the SEBI in 2017. Based on this Report, the SEBI released Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018 w.e.f. 01st April, 2019.

Recent Amendments

Note that, SEBI recently amended the SEBI LODR Regulations, 2015 by notification of:

(i) the SEBI LODR (Second Amendment) Regulations, 2023 (effective from 14 July 2023);

(ii) the SEBI LODR (Third Amendment) Regulations, 2023 (effective from 3 August 2023);

(iii) the SEBI LODR (Fourth Amendment) Regulations, 2023 (effective from 20 September 2023);

(iv) the SEBI LODR (Fifth Amendment) Regulations, 2023 (effective from 1 October 2023);

(v) the SEBI LODR (Sixth Amendment) Regulations, 2023 (effective from 20 October 2023);

(vi) the SEBI LODR (Seventh Amendment) Regulations, 2023 (effective from 21 December 2023).

The amendments seem to be conscious of the market-price driven nature of the public markets and are essentially aimed at:
(a) enhancing and streamlining disclosure requirements for material events / information of a listed entity; and
(b) strengthening corporate governance by empowering shareholders and protecting minority shareholders.

Monetary Rewards for Whistleblowers

In August 2019, the Securities and Exchange Board of India (SEBI) announced monetary reward for whistleblowers, for cases in which the whistleblower's information leads to a disgorgement of at least Rs. 1 crore. The total amount of monetary reward will be 10% of the monies collected, or a maximum of Rs. 1 crore.

---

5. Clause 49 of Listing Agreement, 2000

As a major step towards codifying the Corporate Governance norms, SEBI enshrined the Clause 49 in the Equity Listing Agreement in year 2000, which now serves as a standard of Corporate Governance in India. With Clause 49 was born the requirement that "half the Directors on a listed company's board must be Independent Directors". In the same clause, the SEBI had put forward the responsibilities of the Audit Committee, which was to have a majority Independent Directors.

Clause 49 of the Listing Agreement is applicable to companies which wish to get themselves listed in the stock exchanges. This clause had both mandatory and non-mandatory provisions.

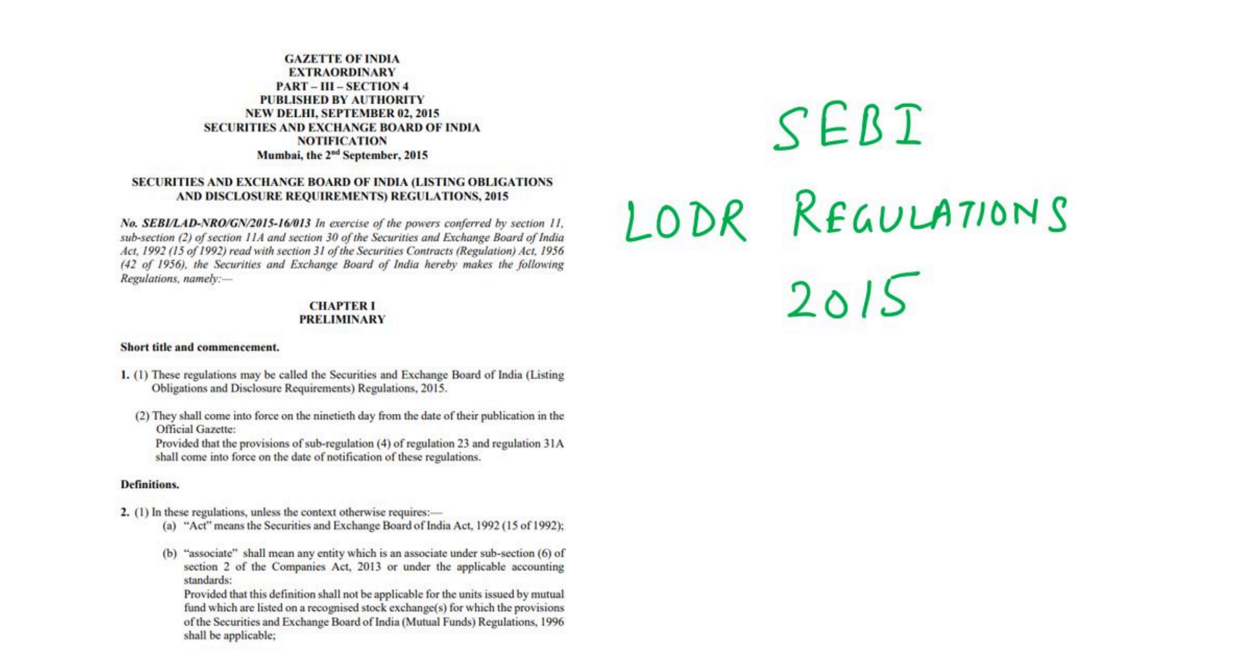
After the enactment of the new Companies Act, 2013, the SEBI amended Clause 49 of the Listing Agreement, in year 2014 to bring it into conformity with the new Act.

Note that **Clause 49 is now subsumed under SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015.**

The salient features of these Regulations are given next.

---

6. SEBI (LODR) Regulations, 2015



GAZETTE OF INDIA
EXTRAORDINARY
PART – III – SECTION 4
PUBLISHED BY AUTHORITY
NEW DELHI, SEPTEMBER 02, 2015
SECURITIES AND EXCHANGE BOARD OF INDIA
NOTIFICATION
Mumbai, the 2nd September, 2015

SECURITIES AND EXCHANGE BOARD OF INDIA (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

No. SEBI/LAD-NRO/GN/2015-16/013 *In exercise of the powers conferred by section 11, sub-section (2) of section 11A and section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) read with section 31 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956), the Securities and Exchange Board of India hereby makes the following Regulations, namely:—*

CHAPTER I
PRELIMINARY

Short title and commencement.

1. (1) These regulations may be called the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

(2) They shall come into force on the ninetieth day from the date of their publication in the Official Gazette:
Provided that the provisions of sub-regulation (4) of regulation 23 and regulation 31A shall come into force on the date of notification of these regulations.

Definitions.

2. (1) In these regulations, unless the context otherwise requires:—
(a) "Act" means the Securities and Exchange Board of India Act, 1992 (15 of 1992);

(b) "associate" shall mean any entity which is an associate under sub-section (6) of section 2 of the Companies Act, 2013 or under the applicable accounting standards:
Provided that this definition shall not be applicable for the units issued by mutual fund which are listed on a recognised stock exchange(s) for which the provisions of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 shall be applicable;

Salient features of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 are given below.

1. Principles of Corporate Governance

The rights of shareholders include the following:

- The company should seek to protect and facilitate the exercise of shareholders' rights.
- The company should provide adequate and timely information to shareholders.
- The company should ensure equitable treatment of all shareholders, including minority and foreign shareholders.

Role of Stakeholders in Corporate Governance

- The company should recognize the rights of stakeholders and encourage co-operation between the company and the stakeholders.

Disclosure and Transparency

- The company should ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the company.

Responsibilities of the Board of Directors

- Disclosure of information
- To perform their key functions of the Board of Directors
- Maintain the rule of confidentiality

2. Composition of Board

The Board of Directors of the company shall have an optimum combination of Executive and Non-Executive Directors with at least one-woman Director and not less than 50% of the Board of Directors comprising Non-Executive Directors.

Where the Chairman of the Board is a Non-Executive Director, at least one-third of the Board should comprise of Independent Directors and in case the company does not have a regular Non-Executive Chairman, at least half of the Board should comprise of Independent Directors.

The 'Independent Director' shall mean a Non-Executive Director, other than a nominee Director of the company.

3. Independent Directors

A person shall not serve as an Independent Director in more than 7 listed companies. Further, any person who is serving as a whole time Director in any listed company shall serve as an Independent Director in not more than 3 listed companies.

An Independent Director shall hold office for a term up to 5 consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to 5 consecutive years on passing of a special resolution by the company.

The company shall issue a formal letter of appointment to Independent Directors in the manner as provided in the Companies Act, 2013.

The "Nomination Committee" shall lay down the evaluation criteria for performance evaluation of Independent Directors.

The Independent Directors of the company shall hold at least one meeting in a year, without the attendance of Non-Independent Directors and members of Management.

The company shall provide suitable training to Independent Directors.

4. Non-Executive Directors' Compensation and Disclosures

All fees/compensation, if any paid to Non-Executive Directors, including Independent Directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in general meeting.

5. Other Provisions as to Board and Committees

The Board shall meet at least 4 times a year, with a maximum time gap of 120 days between any 2 meetings.

6. Code of Conduct

The Board shall lay down a Code of Conduct for all Board members and Senior Management of the company. The code of conduct shall be posted on the website of the company.

7. Whistle Blower Policy

The company shall establish a **vigil mechanism** for Directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy.

8. Audit Committee

The Audit Committee shall be formed for:

- 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;
- Recommendation for appointment, remuneration and terms of appointment of auditors of the company;
- Approval of payment to statutory auditors for any other services rendered by the statutory auditors.

The Audit Committee shall have minimum 3 Directors as members. Atleast 2/3rd of the members of Audit Committee shall be Independent Directors.and in case of a listed entity having outstanding SR (superior) equity shares, the audit committee shall only comprise of independent directors. The Chairman of the Audit Committee shall be an Independent Director.

The Audit Committee should meet at least 4 times in a year and not more than 4 months shall elapse between two meetings. The quorum shall be either 2 members or one third of the members of the Audit Committee whichever is greater, but there should be a minimum of 2 Independent members present.

9. Nomination and Remuneration Committee

The company shall set up a Nomination and Remuneration Committee which shall comprise at least 3 Directors, all of whom shall be Non-Executive Directors and at least 2/3rd of the directors shall be independent. Chairman of the Committee shall be an Independent Director.

The role of the Committee shall be formulation of the criteria for determining qualifications, positive attributes and independence of a Director and recommend to the Board a policy, relating to the remuneration of the Directors, key managerial personnel and other employees.

10. Stakeholders Relationship Committee

The listed entity shall constitute a Stakeholders Relationship Committee to specifically look into various aspects of interest of shareholders, debenture holders and other security holders.

The chairperson of this committee shall be a non-executive director. At least 3 directors, with at least 1 being an independent director, shall be members of the Committee and in case of a listed entity having outstanding SR equity shares, at least 2/3rd of the Stakeholders Relationship Committee shall comprise of independent directors.

11. Risk Management

The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures.

12. Report on Corporate Governance

There shall be a separate section on Corporate Governance in the Annual Reports of company, with a detailed compliance report on Corporate Governance.

7. CG provisions under Companies Act, 2013

The Companies Act, 2013, outlines various requirements for governance, disclosures and enhanced roles, responsibilities and liabilities of the Board, its Committees and Independent Directors.

It has following important provisions relating to Corporate Governance.

Appointment of one-woman Director

Following types of companies shall appoint at least 1-woman Director:

(i) every listed company;

(ii) every other public company having (a) paid–up share capital of Rs.100 Crores or more; or (b) turnover of Rs. 300 Crore or more.

Number of Directorship

The 2013 Act increases the limit for number of Directorships that can be held by an individual from 12 to 15.

Independent Directors

The 2013 Act requires every listed public company to have at least 1/3rd of the total number of Directors as Independent Directors.

The 2013 Act includes Schedule IV 'Code for Independent Directors' which broadly prescribes the following for Independent Directors:

- Professional conduct
- Role and functions
- Duties
- Manner of Appointment
- Reappointment
- Resignation or removal
- Holding separate meetings
- Evaluation mechanism

An Independent Director shall possess appropriate skills, experience and knowledge in one or more fields of Finance, Law, Management, Sales, Marketing, Administration, Research, Corporate Governance, Technical Operations or other disciplines related to the company's business.

Further, there are provisions on "Audit Committee" and "Nomination and Remuneration Committee" in the Companies Act, 2013 too, just like Clause 49.

Other Provisions

Other provisions in the Companies Act, 2013, related to Corporate Governance are given below.

- Appointment and maximum tenure of Independent Directors;
- Appointment of whole-time Key Managerial Personnel;
- Performance Evaluation of the Directors and Committee & Board as a whole;
- Enhanced disclosures and assertions in Board Report, Annual Return and Directors' Report with regard to Managerial Remuneration, Risk Management, Internal Control for Financial Reporting, Legal Compliance, Related Party Transactions, Corporate Social Responsibility, Shareholding Pattern, public money lying unutilized, etc.
- Enhanced compliances of Related Party Transactions and introduction of concept of Arm's Length Pricing;
- Enhanced restrictions on appointment of Auditors and mandatory rotation of Auditors;
- Separation of role of Chairperson and Chief Executive Officer;
- Constitution of NFRA.

All such provisions of new Companies Law are instrumental in providing a good Corporate Governance structure. Further, the Companies (Amendment) Act, 2017 introduces several amendments to the Companies Act, 2013, realigning provisions to improve Corporate Governance and Ease of Doing Business in India while continuing to strengthen compliance and investor protection.

It is to be noted that the Companies Act, 2013 and SEBI (LODR) Regulations, 2015 together deal with virtually all areas affecting Corporate Governance.

8. Corporate Social Responsibility

The Corporate Social Responsibility (CSR) is a new feature added in the Companies Act 2013. It requires Companies having net worth of Rs. 500 crore or more or Turnover of Rs. 1000 crore or Net profit of more than Rs. 5 crore during a Financial Year, have to spend at least 2% of its average Net Profits made during last 3 years in pursuance of CSR activities.

Corporate social responsibility (CSR) is how companies manage their business processes to produce an overall positive impact on society. It covers sustainability, social impact, ethics, philanthropy etc. Companies need to answer to 2 aspects of their operations, which are mentioned below:

1. The quality of their management – both in terms of people and processes (the inner circle).
2. The nature of, and quantity of their impact on society in the various areas.

Thus, CSR can be related to Corporate Governance in numerous ways.

Relationship between CSR and Corporate Governance

The relationship between Corporate Governance and Corporate Social Responsibility can be described as given below.

- CSR is gradually getting fused into companies' Corporate Governance practices. Both CG and CSR focus on the ethical practices in the business and the responsiveness of an organization to its stakeholders and the environment in which it operates.
- Both CG and CSR results into better image of an organization and directly affects the performance of an organization.
- CG emphasizes external regulation and internal control of the firm by legal means and assumes that the monitoring function is controlled by the board of directors and senior managers. CSR is about how the firm regulates its own behavior with reference to social norms.
- CG pertains to both internal and external stakeholders. However, CSR is generally beneficial for external stakeholders. Thus, CSR is seen as a threat to the agent-principal relationship in which the 'agents' (managers) should simply serve the assumed priority of their 'principals' (shareholders).

9. Important Bodies of MCA for Corporate Governance

Some of the important bodies, working for better corporate governance practices, under the Ministry of Corporate Affairs (MCA) are given next.

9. Important Bodies of MCA for Corporate Governance

The Competition Commission of India (CCI) was established under the Competition Act, 2002 by the Central Government with effect from 14th October, 2003. It is the duty of the Commission to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers and ensure freedom of trade in the markets of India.

The CCI consists of a Chairperson and 6 Members appointed by the Central Government. Competition Act, 2002 replaced the erstwhile Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act).

9. Important Bodies of MCA for Corporate Governance

The National Company Law Tribunal, NCLT is a quasi-judicial body in India that adjudicates issues relating to Indian companies. The Tribunal was established under the Companies Act, 2013 and was constituted in 2016 based on the recommendation of **V. Balakrishna Eradi Committee** on law relating to insolvency and winding up of companies. The NCLT bench is chaired by a Judicial member who is a retired/serving High Court Judge and a Technical member. who is from Indian Corporate Law Service, ICLS Cadre.

The NCLT is the adjudicating authority for insolvency resolution process of companies and limited liability partnerships under the Insolvency and Bankruptcy Code, 2016. No criminal court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Tribunal or the Appellate Tribunal is empowered. Decisions of the Tribunal may be appealed to the National Company Law Appellate Tribunal, NCLAT, the decisions of which, may further be appealed to the Supreme Court of India on a point of law.

---

9. Important Bodies of MCA for Corporate Governance

The National Financial Reporting Authority (NFRA) is an independent regulator to oversee the auditing profession and accounting standards in India under Companies Act, 2013. It came into existence in October 2018. The NFRA consists of a Chairperson, who shall be a person of eminence and having expertise in accountancy, auditing, finance or law to be appointed by the Central Government and such other members not exceeding 15 consisting of part-time and full-time members.

Duties of NFRA

The duties of the NFRA are to:

- Recommend accounting and auditing policies and standards to be adopted by companies for approval by the Central Government;
- Monitor and enforce compliance with accounting standards and auditing standards;
- Oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measures for improvement in the quality of service;
- Perform such other functions and duties as may be necessary or incidental to the aforesaid functions and duties.

---

9. Important Bodies of MCA for Corporate Governance

The Investor Education and Protection Fund (IEPF) Authority has been established under the Companies Act, 2013 with the objective of promoting investor education, awareness, protection and to make refunds of shares, unclaimed dividends, matured deposits/debentures etc.

---

9. Important Bodies of MCA for Corporate Governance

The Serious Fraud Investigation Office (SFIO) is a multi-disciplinary investigating agency set up under the Ministry of Corporate Affairs in 2003 with the objective to investigate serious corporate frauds. The Companies Act, 2013, inter alia, has accorded statutory status to SFIO and its functions and powers have been enhanced substantially through enabling provisions in the Act. It is headed by a Director, in the rank of Joint Secretary to the Government of India.

---

10. Whistle Blowing


'No regrets,' says Edward Snowden, after 10 years in exile

But whistleblower says 2013 surveillance 'child's play' compared to technology today

Edward Snowden has been in exile in Russia since 2013 after fleeing Hong Kong, where he handed over tens of thousands of top-secret documents to journalists. Photograph: Baikal/Alamy

Edward Snowden has warned that surveillance technology is so much more advanced and intrusive today it makes that used by US and British intelligence agencies he revealed in 2013 look like child's play.

A **whistleblower** is an individual who discloses private information about an organization to the public or some higher authority, usually related to any wrongdoing, fraud, corruption, etc. A whistleblower could be an employee of a company, contractor, supplier, government agency, etc. who becomes aware of any illegal activities. Besides the provisions in Companies Act, 2013 and Clause 49 of Listing Agreement, for the protection of whistleblowers, Whistleblower Protection Act, 2014 is another step forward for safeguarding the whistleblowers in India.

Every listed company and other classes of companies should establish a **Vigil mechanism** for Directors and employees to report genuine concern.

Whistle blowing refers to the act of employees or insiders reporting unethical or illegal activities within their organizations to the relevant authorities or stakeholders. Whistleblowers play a crucial role in exposing wrongdoing, fraud, corruption, or any form of malpractice that may be harmful to the company, its stakeholders, or the public interest.

---

11. Whistle blowers Protection Act, 2014

The Whistle blowers Protection Act, 2014 was passed in Parliament on February 21, 2014.

The provisions of Whistleblowers Protection Act, 2014 are listed next.

The Act states that any person, including a public servant, NGO etc., may make a public interest disclosure related to an act of corruption, willful misuse of power or discretion, or criminal offence by a public servant.

A **public interest disclosure** is made before a 'Competent Authority' and it should be in writing or by electronic mail. The Act specifies the 'Competent Authority' for each category of public servant. For example, it would be the Prime Minister for a Union Minister; Speaker/ Chairman for Members of Parliament; High Court for district court judges; the Central or State Vigilance Commission for government servants etc.

A **public servant** shall include ministers, members of Parliament, the lower judiciary, regulatory authorities, central and state government employees, etc. It shall not include a Judge of the Supreme Court or a Judge of a High Court.

The Competent Authority shall conceal the identity of the complainant, unless the complainant has himself revealed his identity. The Competent Authority shall conduct a discreet inquiry to ascertain whether the disclosure requires to be investigated.

If the Competent Authority is of the opinion that the disclosure requires to be investigated, it shall seek comments or explanation or report from the Head of the Department of the organisation or authority. The Competent Authority or the Head of the Department shall not reveal the identity of the complainant unless necessary for investigation. It shall be done only with prior written consent of the complainant. If the Competent Authority is of the opinion that the facts and allegations contained in the disclosure are frivolous or vexatious, it shall close the matter.

If the Competent Authority is of the opinion that there has been willful misuse of power or willful misuse of discretion or substantiates allegations of corruption, it shall recommend to the public authority to take the following measures: (**Public authority** means any authority, body or institution falling within the jurisdiction of the Competent Authority)

- initiating proceedings against the concerned public servant;
- taking appropriate administrative steps for redressing the loss caused to the Government;
- recommend to the appropriate authority or agency for initiation of criminal proceedings, if so warranted by the facts and circumstances of the case;
- recommend for taking of corrective measures;
- take any other measures not falling under clauses (i) to (iv) which may be necessary for the purpose of this Act.

The public authority shall take decision within 3 months of receipt of recommendation made by competent authority. If the public authority does not agree with the recommendation of the Competent Authority, it shall record the reasons for such disagreement.

The Competent Authority shall finally inform the complainant about the action taken on the complaint and the final outcome thereof. In a case where, after making an inquiry, the Competent Authority decides to close the case, it shall, before passing the order for closure of the case, provide an opportunity of being heard to the complainant, if the complainant so desires.

A Public interest disclosure shall not be allowed, which is likely to prejudicially affect the interest of the sovereignty and integrity of India, the security of the State, friendly relations with foreign State, public order, decency or morality or in relation to contempt of court, defamation or incitement to an offence. Also, the provisions of the Act shall not apply to the armed forces of the Union.

Safeguards

The Act provides adequate safeguards against victimization of the person making such disclosure. Such safeguards can be mentioned below:

- The complainant may file an application before the Competent Authority to seek protection against victimization and such authority shall take necessary action.
- The Competent Authority, at any time after the making of disclosure by the complainant or public servant, if it is of the opinion that any corrupt practice required to be stopped during the continuation of any inquiry for the said purpose may pass such interim orders as it may deem fit, to prevent the immediate stoppage of such practice.

Penalties under the Act

The following are some penalties imposed under the Act.

- If the organisation or official concerned has not furnished the report within the specified time or malafidely refused to submit the report, a penalty of upto Rs. 250 per day shall be imposed till report is furnished. The total amount of such penalty shall not exceed Rs. 50,000. However, if the organisation or official concerned, has knowingly given incomplete, incorrect or misleading or false report or destroyed record or information which was the subject of the disclosure, a penalty of upto Rs. 50,000 shall be imposed. Provided that no penalty shall be imposed against any person unless he has been given an opportunity of being heard.
- Any person who negligently or malafidely reveals the identity of a complainant shall be punishable with imprisonment for a term extending up to 3 years and a fine which may extend up to Rs 50,000.
- If the disclosure is done mala-fidely and knowingly that it was incorrect or false or misleading, the person shall be punishable with imprisonment for a term extending up to 2 years and a fine extending up to Rs. 30,000.

Any person aggrieved by any order of the Competent Authority related to imposition of penalties as above, can make an appeal to the concerned High Court within a period of 60 days from the date of the order.

Proposed Amendment

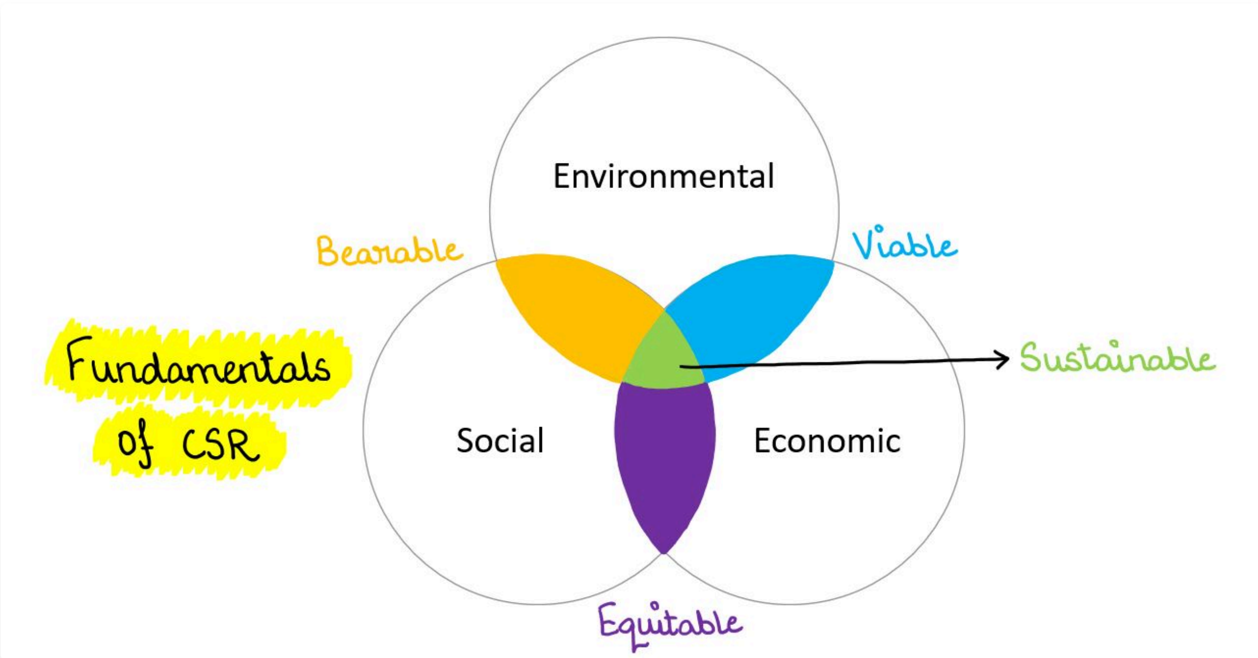
An amendment to the aforementioned Act was proposed in the form of the Whistleblowers Protection (Amendment) Bill, 2015. The Whistleblowers Protection (Amendment) Bill, 2015 was introduced in Lok Sabha on May 11, 2015. However, the Amendment Bill was not passed by the Rajya Sabha and consequently, it lapsed.

1. Concept of CSR

Corporate Social Responsibility (CSR, also called corporate conscience, corporate citizenship, social performance, or sustainable responsible business/ Responsible Business) refers to a company's commitment to operating in an ethical and sustainable manner while considering the interests of various stakeholders beyond solely maximizing profits. It involves integrating social and environmental concerns into a company's business operations and interactions with its stakeholders, including employees, customers, communities, and the environment.

CSR encompasses various initiatives that go beyond legal obligations and aim to make a positive impact on society and the environment. These initiatives may include ethical business practices, philanthropic activities, environmental sustainability efforts, responsible supply chain management, employee welfare programs, and community development projects.

The fundamental principle behind CSR is that businesses should not only strive for financial success but also actively contribute to the well-being of society and the environment. Embracing CSR can enhance a company's reputation, foster customer loyalty, attract and retain talent, mitigate risks, and create long-term sustainable value for both the business and society.



As we see in the diagram, CSR is about behaviour of business on all 3 fronts, social, environmental and economic.

In 1899, **Andrew Carnegie**, founder of the conglomerate US Steel corporation published a book called The Gospel of Wealth, which set forth the classic statement of corporate social responsibility. Carnegie's view was based on 2 principles: (i) the charity principle and (ii) the stewardship principle.

The **charity principle** calls for wealthy individuals and organizations to help the less fortunate in society, but charity should be given only to those who really need it and will help themselves. The **stewardship principle** required businesses and wealthy individuals to view themselves as the stewards, or caretakers, of their property.

Carnegie holds the idea that the rich hold their money “in trust” for the rest of society and can use it for any purpose that society deems legitimate.

---

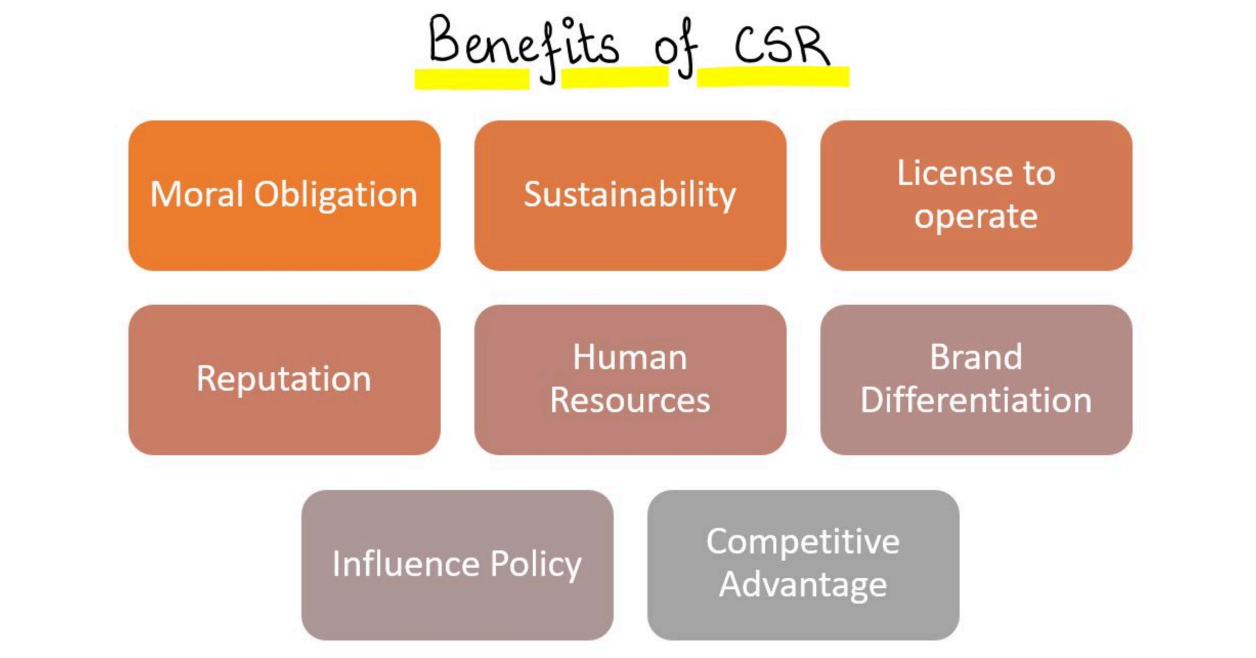
1. Concept of CSR

Social accounting, often referred to as social auditing, pertains to the systematic process of communicating a company's social and environmental impacts resulting from its economic activities to specific interest groups within society and the broader public. It's a critical component of Corporate Social Responsibility (CSR), enabling businesses to demonstrate accountability for their actions beyond financial performance.

This practice aims to highlight a firm's socially relevant behaviors and accomplishments, underscoring the identification of stakeholders to whom the company is answerable for its social performance. Social accounting involves the development of suitable measures, reporting techniques, and frameworks to track, measure, and communicate a company's social and environmental initiatives and impacts transparently.

---

1. Concept of CSR



The benefits of pursuing CSR activities are discussed below.

Moral obligation
It is the duty for a company to be a good citizen and to do 'the right thing'.

Sustainability
It is the emphasis on the environmental and community impact of the business. To an extent this may reflect enlightened self-interest.

License to operate
It is the tacit or explicit permission a company needs from governments, communities and other stakeholders to do business. There are many provisions on CSR in the Companies Act 2013.

Reputation
The CSR initiatives enhances a company's image, strengthen its brand, improve morale, or even raise share prices. Some organisations have a distinctive position based on an extraordinary long-term commitment to social responsibility.

Human resources
A CSR program can be an aid to recruitment and retention, particularly within the competitive talent market. CSR can also help improve the perception of a company among its staff, particularly when staff can become involved through payroll giving, fund-raising activities or community volunteering. CSR has been found to encourage customer orientation among frontline employees.

Brand differentiation
In crowded marketplaces, companies strive for a unique selling proposition (USP) that can separate them from the competition in the minds of consumers. CSR can play a role in building customer loyalty based on distinctive ethical values. Several major brands, such as Tata, Infosys are built on ethical values.

Influence Policy
Corporations are keen to avoid interference in their business through taxation or regulations. By taking substantive voluntary steps, they can persuade governments and the wider public that they are taking issues such as health and safety, diversity, or the environment seriously as good corporate citizens with respect to labour standards and impacts on the environment.

Competitive Advantage
The CSR-based positioning of firm provides competitive advantage.

Thus, the CSR is identified as a strategic opportunity, which has far greater importance than moral duty alone.

2. Models of CSR

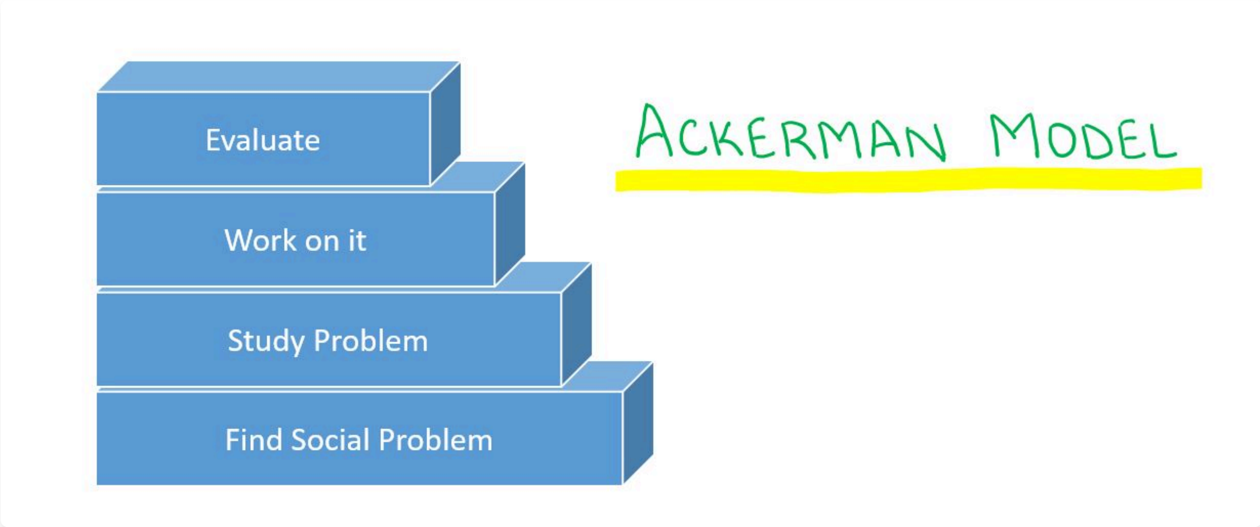
The following Models of CSR are discussed next.

- Ackerman's Model
- Pyramid Model
- Intersecting Circles Model
- Concentric Circles Model
- 3C-SR Model
- Liberal Model
- Stakeholder Model

In addition, there are also 2 Indian models of CSR.

- Ethical Model
- Statist Model.

2. Models of CSR



Ackerman Model emphasizes on the internal policy goals and their relation to the CSR.

According to this Model, the 4 stages involved in CSR include:

1. Managers of company getting to know the most common social problem and then express a willingness to take a particular project which will solve some social problems.

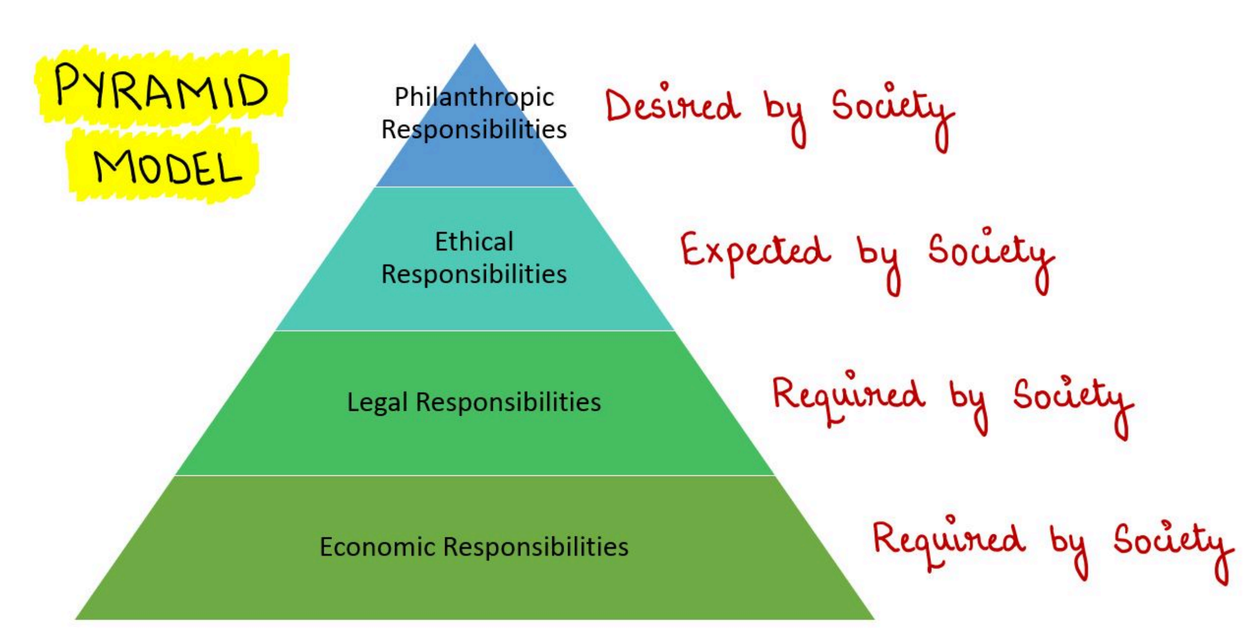
2. Intensive study of the problem by hiring experts & getting their suggestions to make it operational.

3. Managers take up the project actively and work hard.

4. Evaluating the project by addressing the issues.

It is evident that this model, more of a plan, offers strategies specifically for addressing problems with social implications, excluding other parameters and constraints related to CSR activities.

2. Models of CSR

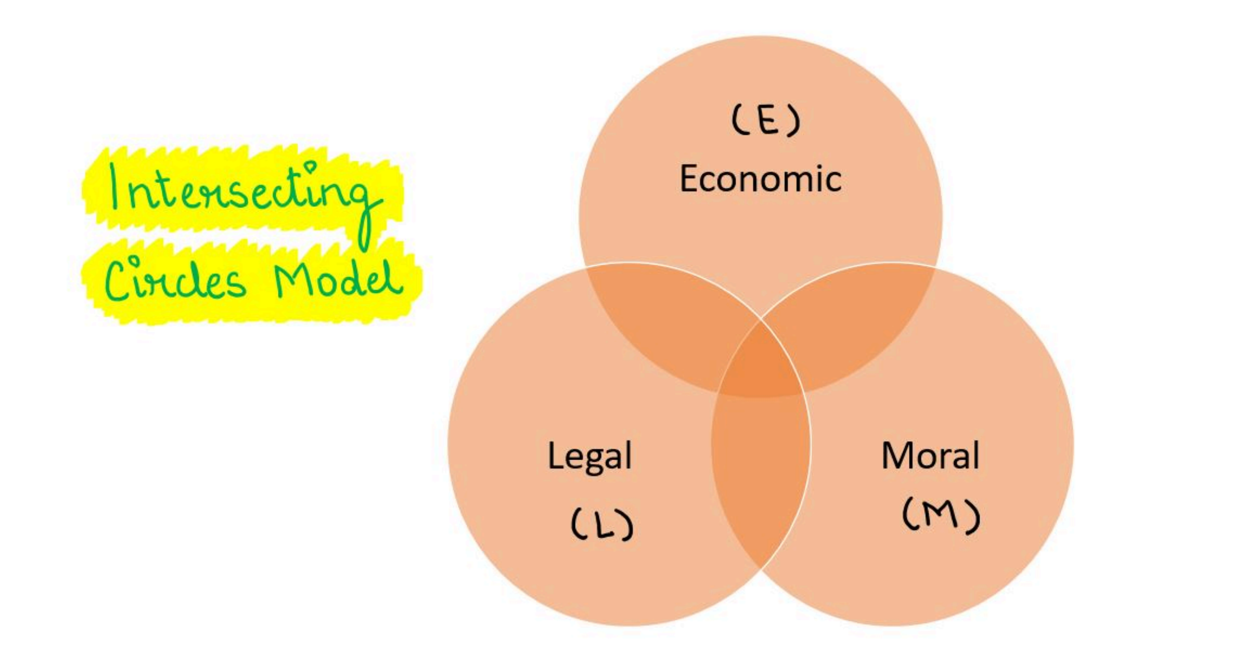


In his 1991 article titled "The Pyramid of Corporate Social Responsibility," Dr. Archie B. Carroll, a business management author and professor, outlines four key areas constituting the corporate social responsibility pyramid: legal, economic, ethical, and philanthropic.

The pyramid is structured in descending order of priorities, with **economic responsibilities** being the most crucial. Carroll emphasizes that "all other business responsibilities hinge upon the economic responsibility of the firm because, without it, the others become moot considerations." **Legal responsibility** is the second priority, followed by **ethical responsibility**, encompassing obligations not legally codified but deemed essential for the greater good. **Philanthropic responsibilities**, characterized as discretionary, receive the lowest priority in this framework.

2. Models of CSR

This model, unlike the pyramid model, categorically refutes the hierarchical prioritization of CSR and illustrates the integration of 3 aspects: economic, legal and moral.



Schwartz and Carroll (2003) proposed this model to illustrate the fact that when it comes to CSR, none of the aspects are more important than the other.

The model states that different responsibilities are in dynamic interplay with each other. It is the responsibility of the corporates to maintain harmony and resolve the conflicts between different responsibilities. The main idea of the model is that no responsibility is more important than the other. Rather everything is a social creation and the existence of everything depends on the willingness of society to support them.

2. Models of CSR

The concentric circles model of CSR has been adopted from a statement issued in 1971 by the Committee for Economic Development. The statement posited that social contracts of business processes are not only feasible, but also morally necessary and, thus, urged corporations to adopt a more humane view towards their function in society.

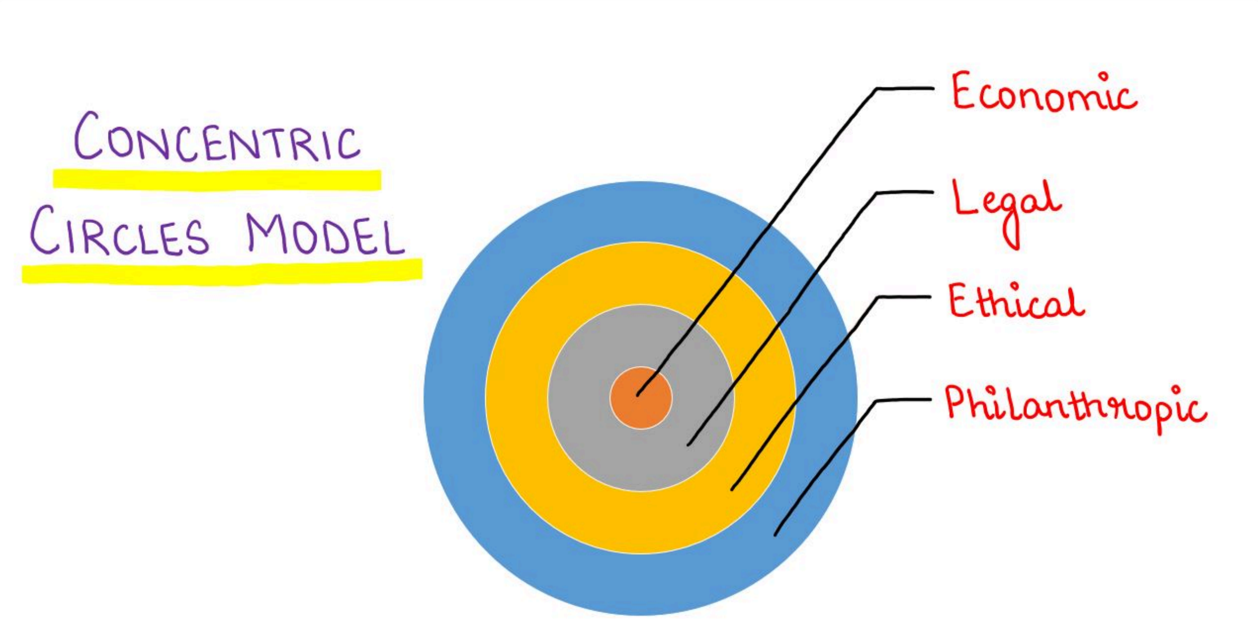
The original model of the committee had only 3 rings:

(a) **economic** (products, job, financial stability and growth);

(b) **ethical** (responsibilities to exercise the economic functions with a sensitive awareness of ethical norms) and

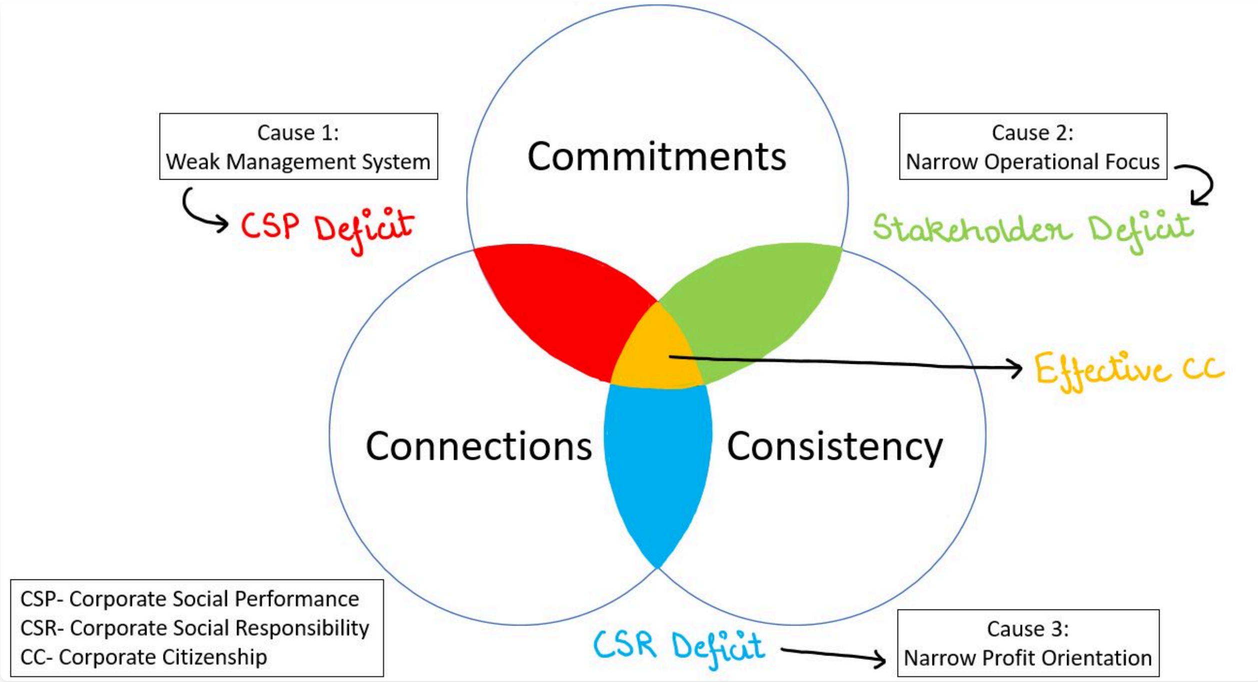
(c) **philanthropic** (amorphous responsibilities that businesses should get involved with to improve the social environment).

On the one hand, the move from the outer circle to the inner circle reflects the control that society needs to impose on standards of business activity to ensure social progress through proper functioning of the business core. The move from the inside to outside, on the other hand, represents the internalization of social norms that reside and operate within the business as affirmative or positive duties.



Later, one more circle was added to represent the **legal responsibilities** that involve cooperating with the government on the part of the businesses.

2. Models of CSR



This model was proposed by John Meehan, Karon Meehan and Adam Richards of Liverpool John Moores University.

As per this model, the CSR can equally well be framed as a competitive resource and habituated to the normal processes of strategy development and measurement. In this way CSR becomes a means to, rather than drain on, business success (measured in terms of the triple bottom line).

Social Resources are made up of **3 inter-related components** whose simultaneous presence underwrites the credibility of a product/service offer targeted at the "ethical consumer".

The components of the model are:

1. ethical and social **C**ommitments;

2. **C**onnections with partners in the value network; and

3. **C**onsistency of behaviour over time to build trust.

Weakness in one of these areas will result in a failure to adequately achieve a real corporate responsibility orientation and building competitive strategies around social resources.

Commitments are formed from legal, ethical and economic dimensions of the business. **Connections** are defined in complex constellations of creating value chain in business operations. **Consistency** brings predictability, trust and loyalty. Business is required to walk-the-talk otherwise firms may fall into ill-fame through inconsistency of behaviour.

The figure shows the interconnectedness of the expected firm 3Cs. To achieve effective corporate citizenship, where corporate citizenship is a platform for effective CSR, a firm must find activities that link the company connections, consistency and commitments in the marketplace.

2. Models of CSR

Liberal Model was encapsulated by the American economist Milton Friedman, who in 1958 challenged the very notion of corporate responsibility with the idea that companies are solely responsible to their owners (and thus should focus on maximizing profits). As argued in this model, it is sufficient for a business to obey the law and generate wealth, which through taxation and private charitable choices can be directed to social ends. This ultimately fulfils the social responsibility of an organization towards the community and the nation.

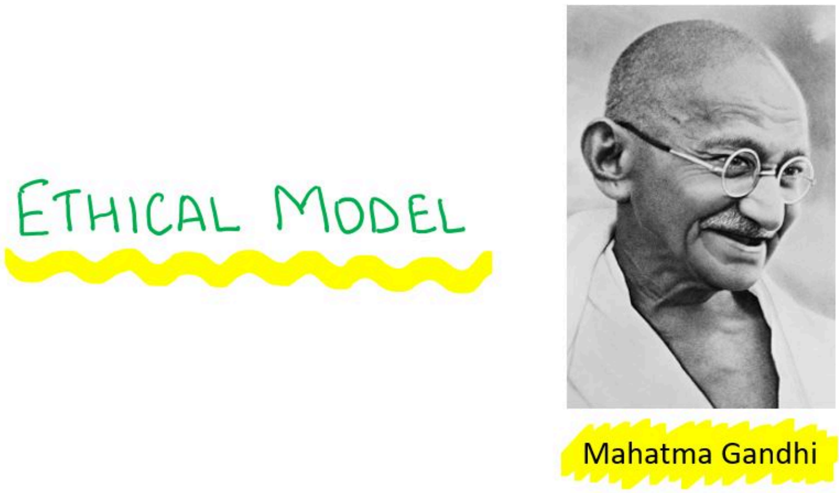
---

2. Models of CSR

The stakeholder model is often associated with R. Edward Freeman, whose seminal analysis of the stakeholder approach to strategic management in 1984 brought stake holding into the mainstream of management literature. Stakeholder Theory stresses the interconnected relationships between a business and its customers, suppliers, employees, investors, communities and others who have a stake in the organization. The theory argues that a firm should create value for all stakeholders, not just shareholders. This, as a consequence, gave rise to the stakeholder model of corporate responsibility.

---

2. Models of CSR



The ethical model of Corporate Social Responsibility (CSR) is rooted in the early 20th century and draws inspiration from Mahatma Gandhi's philosophy. This model emerged as a response to the call for social development commitment by Indian industrialists. Mahatma Gandhi's concept of trusteeship influenced the development of this model, advocating that corporate owners should voluntarily manage wealth on behalf of society.

The model is based on the principle of trusteeship, where corporate owners are seen as trustees of wealth and resources. Corporates are expected to manage their resources not only for profit but also with a strong commitment to the well-being and development of society.

The ethical model encourages philanthropic activities as a way for corporations to fulfill their social responsibilities. Examples of such initiatives include kind or cash donations, community investment trusts, and the provision of critical services like hospitals, libraries, and schools.

The ethical model has been exemplified by Indian industrialists, with notable contributions from corporations such as Reliance (Ambanis) and Tata. These companies have been involved in significant philanthropic activities, showcasing a commitment to social development and community well-being.

2. Models of CSR

The statist model of Corporate Social Responsibility (CSR) is rooted in the adoption of socialist and mixed economies, particularly associated with the policies implemented by Jawaharlal Nehru. In this model, corporate responsibilities are predominantly governed by state ownership and legal requirements. The framework for corporate responsibility is embedded in labor laws and management principles, with a focus on community and worker relationships.

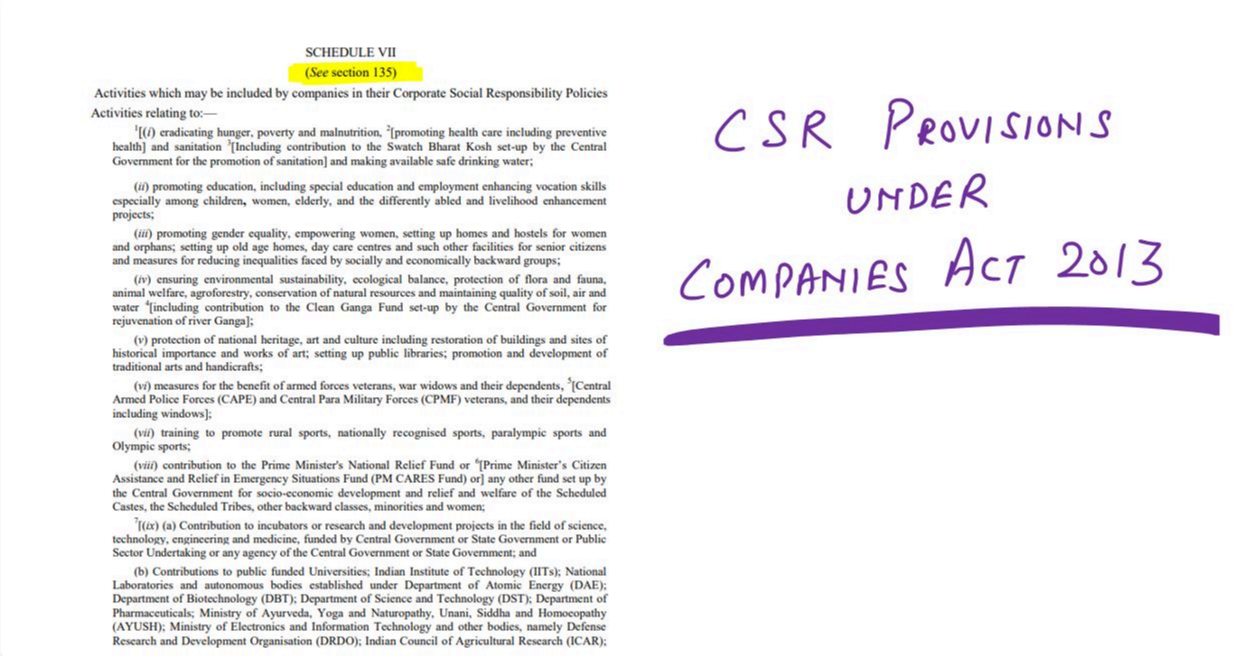
Under the statist model, there is a significant emphasis on state ownership of key industries and enterprises. The government plays a central role in owning and controlling businesses, often with the aim of aligning corporate activities with broader social objectives.

Corporate responsibilities are largely defined by legal mandates imposed by the state. The government sets specific regulations and standards that companies are required to adhere to in terms of their social and environmental conduct.

Many public sector companies continue to follow the statist model, reflecting a state-sponsored corporate philosophy. The government, as the owner of these enterprises, assumes a direct role in shaping and overseeing their corporate responsibility initiatives.

The corporate philosophy in this model is influenced and sponsored by the state, reinforcing the alignment of business activities with social and economic goals.

3. CSR provisions under Companies Act 2013



SCHEDULE VII

(*See* section 135)

Activities which may be included by companies in their Corporate Social Responsibility Policies

Activities relating to:—

[1][(*i*) eradicating hunger, poverty and malnutrition, [2][promoting health care including preventive health] and sanitation [3][Including contribution to the Swatch Bharat Kosh set-up by the Central Government for the promotion of sanitation] and making available safe drinking water;

(*ii*) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;

(*iii*) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

(*iv*) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water [4][including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga];

(*v*) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

(*vi*) measures for the benefit of armed forces veterans, war widows and their dependents, [5][Central Armed Police Forces (CAPE) and Central Para Military Forces (CPMF) veterans, and their dependents including windows];

(*vii*) training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports;

(*viii*) contribution to the Prime Minister's National Relief Fund or [6][Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES Fund) or] any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

[7][(*ix*) (a) Contribution to incubators or research and development projects in the field of science, technology, engineering and medicine, funded by Central Government or State Government or Public Sector Undertaking or any agency of the Central Government or State Government; and

(b) Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and autonomous bodies established under Department of Atomic Energy (DAE); Department of Biotechnology (DBT); Department of Science and Technology (DST); Department of Pharmaceuticals; Ministry of Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homoeopathy (AYUSH); Ministry of Electronics and Information Technology and other bodies, namely Defense Research and Development Organisation (DRDO); Indian Council of Agricultural Research (ICAR);

The Companies Act, 2013 prescribes the provisions in relation to Corporate Social Responsibility (CSR). The concept of CSR rests on the ideology of give and take. Companies take resources in the form of raw materials, human resources etc. from the society. By performing the task of CSR activities, the companies are giving something back to the society.

The Ministry of Corporate Affairs has notified **Section 135** and **Schedule VII** of the Companies Act as well as the provisions of the Companies (Corporate Social Responsibility Policy) Rules, 2014 (CSR Rules) which has come into effect from 1st April 2014. Further, on 22nd January 2021, the Government of India brought into effect the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021, thereby, amending the existing CSR Rules.

These Rules were last amended on 20 September, 2022.

The CSR provisions under Companies Act 2013 are given next.

3. CSR provisions under Companies Act 2013

Section 135 of the Companies Act 2013 provides the threshold limit for applicability of the CSR to a Company. Accordingly, every company, private limited or public limited, which either has a net worth of Rs 500 crore or more; or a turnover of Rs 1,000 crore or more; or net profit of Rs 5 crore or more, **needs to spend at least 2% of its average net profit for the immediately preceding 3 financial years on corporate social responsibility activities.** The company which has not completed the period of 3 financial years since its incorporation, need to spend at least 2% during such immediately preceding financial years, in pursuance of its CSR Policy. The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities.

Amendments

As per *July 2019* Amendment, now, the unspent CSR funds can be carried forward to a special account and the same has to be spent within 3 financial years. In case, the money remains unspent, then it should be transferred to any fund specified in Schedule VII of the Act, within 30 days from end of 3rd Financial Year.

The CSR activities should not be undertaken in the normal course of business and must be with respect to any of the activities mentioned in *Schedule VII of the 2013 Act*. Contribution to any political party is not considered to be a CSR activity and only activities in India would be considered for computing CSR expenditure.

In *March 2020*, the Ministry of Corporate Affairs came out with a notification that funds spends on COVID-19 related activities would be treated as CSR expenditure under Schedule VII of the Companies Act 2013. The Contribution made to ‘PM CARES Fund' or 'State Disaster Management Authority', are also eligible.

Further, as per the earlier provisions, the CSR provisions ceased to be applicable on a company when it ceased to meet the criteria as specified in Section 135(1) for 3 consecutive financial years. Under the new Rules of *September 2022*, this provision has been dispensed with. Once the CSR provisions become applicable on a company, they will continue to be applicable.

---

3. CSR provisions under Companies Act 2013

To formulate and monitor the CSR policy of a company, a CSR Committee of the Board needs to be constituted. Section 135 of the 2013 Act, requires the CSR Committee to consist of at least 3 directors, including an independent director.

Where the amount to be spent by a company does not exceed Rs 50 Lakh, the requirement for constitution of the CSR Committee shall not be applicable and the functions of such Committee shall, in such cases, be discharged by the Board of Directors of such company.

---

3. CSR provisions under Companies Act 2013

To address the pandemic, the Rules have amended the definition of Corporate Social Responsibility, in January 2021, to clarify that activities undertaken in pursuance of normal course of business of the company shall not be included under the ambit of CSR.

However, any company engaged in research and development activity of new vaccine, drugs and medical devices in their normal course of business may undertake research and development activity of new vaccine, drugs and medical devices related to COVID-19 for financial years 2020-21, 2021-22, 2022-23 as CSR.

The Rules have further clarified that any activity undertaken by the company outside India shall not be considered as CSR unless such an activity pertains to training of Indian sports personnel representing the country at an international level or representing any state or union territory at a national level.

Further, it has been clarified that contribution of any amount directly or indirectly to any political party; or activities benefitting employees of the company, as defined under Code on Wages, 2019; or activities supported by companies on a sponsorship basis for deriving marketing benefits for its products or services; or activities carried out for fulfillment of any other statutory obligations under any law in force in India, are also excluded from the purview of CSR.

---

3. CSR provisions under Companies Act 2013

As per CSR Amendment Rules, 2021, the CSR Committee shall formulate and recommend to the Board, an **annual action plan in pursuance of its CSR policy**, which shall include the following, namely:

(a) the list of CSR projects or programmes that are approved to be undertaken in areas or subjects specified in Schedule VII of the Act;

(b) the manner of execution of such projects or programmes;

(c) the modalities of utilisation of funds and implementation schedules for the projects or programmes;

(d) monitoring and reporting mechanism for the projects or programmes; and

(e) details of need and impact assessment, if any, for the projects undertaken by the company.

---

3. CSR provisions under Companies Act 2013

Companies can now undertake multi-year projects to fulfill its CSR obligation, having timelines not exceeding 3 years excluding the financial year in which it was commenced.

---

3. CSR provisions under Companies Act 2013

The activities that can be undertaken by a company to fulfil its CSR obligations include eradicating hunger, poverty and malnutrition, promoting preventive healthcare, promoting education and promoting gender equality, setting up homes for women, orphans and the senior citizens, measures for reducing inequalities faced by socially and economically backward groups, ensuring environmental sustainability and ecological balance, animal welfare, protection of national heritage and art and culture, measures for the benefit of armed forces veterans, war widows and their dependents, training to promote rural, nationally recognized, Paralympic or Olympic sports, contribution to the prime minister's national relief fund or any other fund set up by the Central Government for socio economic development and relief and welfare of SC, ST, OBCs, minorities and women, contributions or funds provided to technology incubators located within academic institutions approved by the Central Government and rural development projects.

---

3. CSR provisions under Companies Act 2013

The amended Rules states that a Company can undertake CSR activities by itself or through any company incorporated under Section 8 (companies with charitable objects) of the Act or a registered public trust, or registered society under Sections 12A and 80G of the Income Tax Act, 1961.

A company may also engage international organizations for designing, monitoring and evaluation of the CSR projects or programmes as per its CSR policy. The CSR Committee shall formulate and recommend to the Board, an annual action plan in pursuance of its CSR Policy.

Companies can also collaborate with each other for jointly undertaking CSR activities, provided that each of the companies are able to individually report on such projects.

Note that earlier, only those companies established under the provisions of Sec, 8 of the Act, or registered public trusts or registered societies who were registered under Sec. 12A and 80 G of the Income Tax Act, 1961 were eligible under the said rule. Now, the scope has been widened to include those companies established under Sec. 8 of the Act, or registered public trusts or registered societies which are exempted under clause 23C of Sec. 10 or registered under section 12A and approved under 80 G of the Income Tax Act, 1961.

---

3. CSR provisions under Companies Act 2013

The Board of a Company shall ensure that the administrative overheads shall not exceed 5% of total CSR expenditure of the company for the financial year. Administrative overheads means the expenses incurred by the company for general management and administration of the CSR functions in the company but shall not include expenses directly incurred for designing, implementation, monitoring, and evaluation of a particular CSR project or program.

---

3. CSR provisions under Companies Act 2013

Any surplus arising out of the CSR activities shall not form part of the business profit of a company and shall be ploughed back into the same project or shall be transferred to the unspent CSR Account.

3. CSR provisions under Companies Act 2013

Where a company spends an amount in excess of requirement, such excess amount may be set off against the requirement to spend up to immediate succeeding 3 financial years, provided such excess available for set off shall not include the surplus arising out of CSR activities, and the Board of the Company shall pass a resolution to that effect.

3. CSR provisions under Companies Act 2013

The report of the Board of Directors attached to the financial statements of the Company would also need to include an annual report on the CSR activities of the company in the format prescribed in the CSR Rules setting out inter alia a brief outline of the CSR policy, the composition of the CSR Committee, the average net profit for the last 3 financial years and the prescribed CSR expenditure.

In case of foreign companies, annual report on CSR shall be a part of the balance sheet. Every company having average CSR obligation of Rs. 10 crore or more in 3 immediately preceding financial years, shall undertake **impact assessment,** through an independent agency, of their CSR projects, having outlays of Rs 1 crore or more and which have been completed at least 1 year before undertaking the impact study. The impact assessment reports shall be placed before the Board and shall be annexed to the annual report on CSR.

3. CSR provisions under Companies Act 2013

If a Company which is having remaining unspent amount as on March 31 and it does not have on-going project, then the Company is required to transfer such unspent amount to a Fund as specified in Schedule VII, within 6 months of the expiry of the financial year.

If a Company having on-going project, then the Company is required to transfer such unspent amount:

- within a period of 30 days from the end of the financial year
- to a special account to be opened by the company
- for that particular financial year
- in any scheduled bank
- to be called the ‘Unspent Corporate Social Responsibility Account’
- and such amount shall be spent by the company in pursuance of its obligation towards the CSR Policy
- within a period of 3 financial years from the date of such transfer.

If a Company fails to do so, then the company is required to transfer the same to a Fund specified in Schedule VII, within a period of 30 days from the date of completion of the 3rd financial year.

4. National CSR Awards

The National CSR Awards (NCSRA) have been instituted by the Ministry of Corporate Affairs to recognize corporate initiatives in the area of Corporate Social Responsibility (CSR) to achieve inclusive growth and inclusive and sustainable development. These awards are the highest recognition in the domain of CSR by the Government of India.

The NCSRA seeks to recognize outstanding projects in following 3 categories:

- 4 awards for Excellence in CSR, based on CSR spend
- 5 awards for CSR projects in aspirational districts
- 11 awards for CSR projects in National Priority Areas

3 Awards (one in each main categories of the awards), are reserved for MSMEs for the CSR intervention(s), in alignment with Category Objective/s, carried out by Micro, Small and Medium Enterprises within the provisions of Section 135 of Companies Act 2013 and the rules there under.

In addition to 20 awards as mentioned above, there may be 20 Runners-Up for companies which have under taken appreciable CSR activities in given sub-categories.

First National CSR Awards were presented by the President of India in October 2019. Going forward, National CSR Awards will be given away on 2 October every year.

1. Introduction

Business Ethics refers to the principles, values, and moral standards that guide the behavior and decisions of individuals and organizations within the context of the business environment. It involves considering not only the financial and operational aspects of business, but also the social, environmental, and ethical implications of actions and choices. Business ethics aims to promote responsible and ethical conduct in business activities, taking into account the interests of stakeholders, society, and the environment.

Key aspects of business ethics include:

- *Integrity:* Upholding honesty and truthfulness in all business interactions and communications.
- *Fairness:* Treating all stakeholders fairly and impartially, without favoritism or discrimination.
- *Respect:* Respecting the rights, dignity, and diversity of individuals and groups involved in or affected by business operations.
- *Transparency:* Providing clear and accurate information about products, services, and business practices to stakeholders.
- *Accountability:* Taking responsibility for the consequences of business decisions and actions.
- Compliance: Adhering to laws, regulations, and industry standards, and avoiding illegal or unethical activities.
- *Sustainability:* Considering the long-term impact of business activities on the environment, society, and future generations.
- *Social Responsibility:* Engaging in activities that contribute positively to society, communities, and stakeholders.
- *Corporate Governance:* Ensuring effective oversight, decision-making, and accountability within organizations.
- *Ethical Leadership:* Demonstrating ethical behavior and setting a positive example for employees and stakeholders.

As per **Louis A. Allen**, a manager must adhere to 6 ethical principles in fulfilling their responsibilities; Integrity, Impartiality, Responsiveness to the public interest, Honesty, Transparency, and Accountability.

1. Introduction

An increasing number of companies have come to acknowledge the correlation between business ethics and the performance of a company. Companies that demonstrate a "clear dedication to ethical behavior" consistently outshine their counterparts that lack such ethical commitment.

Here are some of the benefits associated with this approach.

Attraction and Retention of Talent

Organizations that uphold strong ethical values are becoming a magnet for individuals seeking employment. These companies have the ability to draw in the most skilled and talented professionals.

Investor Fidelity

Investors are progressively recognizing that an ethical environment provides the groundwork for efficiency, productivity, and profitability. Relationships with stakeholders, including investors, established on reliability, trust, and dedication lead to enduring loyalty.

Enhanced Customer Satisfaction

A company's reputation should evoke trust and admiration from customers for sustained success. This accomplishment is attainable only through the adoption of ethical practices. Such ethical adherence equips companies to navigate challenging circumstances. Ethical dealings with customers establish a formidable competitive stance for the company.

Mitigation of Legal Issues

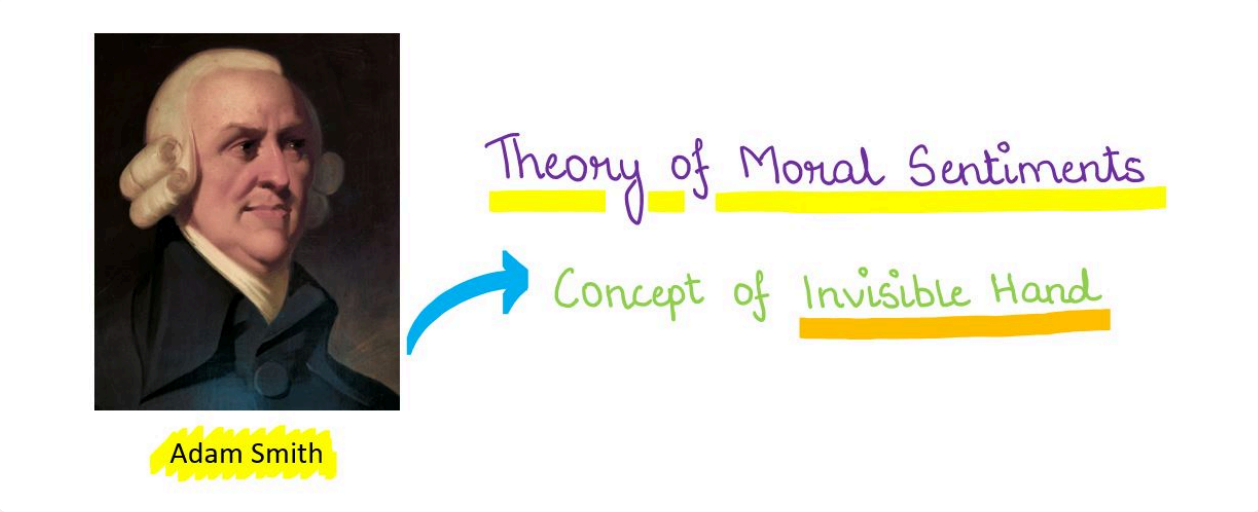
The temptation for a company's management to compromise ethical standards in the pursuit of profit can arise. This might involve skirting environmental regulations, labor laws, neglecting worker safety concerns, or using substandard materials in products. If discovered, the repercussions can be substantial, including legal expenses, fines, or sanctions from regulatory bodies. The resulting negative public attention can also inflict long-term harm on the company's reputation, potentially surpassing the financial impact of fines or legal fees.

Positive Organizational Atmosphere

Employees bear a responsibility to uphold ethical standards. They should be forthright about their abilities and experience. Ethical employees are regarded as team players rather than individual contributors. They cultivate constructive relationships with colleagues and are entrusted by their supervisors with confidential information.

1. Introduction

In the field of ethics and morality, the contribution of Adam Smith is noteworthy.



Adam Smith's inaugural major published work was "The Theory of Moral Sentiments." Released in 1759, it originated from his lectures presented at Glasgow University, following his appointment as the Professor of Moral Philosophy in 1752. Smith's contention is that morality does not stem from an inherent moral intuition, but rather from humanity's innate sociability - the urge for acceptance from our peers. Our behavior towards one another is shaped to facilitate harmonious coexistence, driven not by a rational calculation for personal gain but by our emotions, primarily our capacity for empathy.

Smith also introduces his renowned concept of the **invisible hand**. He proposes that the unintended outcomes of our self-interested actions lead to the establishment of social institutions that enable the smooth functioning of society. The wealthy only select what is most valuable and pleasing from the resources. Their consumption isn't significantly higher than that of the poor. Despite their inherent self-centeredness and greed, they unwittingly contribute a share of their improvements to the less fortunate. Guided by an unseen force, they inadvertently bring about a distribution of essential resources that closely mirrors what would have transpired had the earth been divided equally among all its inhabitants. Thus, inadvertently and unknowingly, they advance society's interests, fostering conditions for population growth.

2. What is Code of Conduct

A Code of Conduct is a set of established guidelines and principles that dictate the ethical behavior and standards expected of individuals within a particular organization, profession, or community. This code serves as a framework to guide the actions, decisions, and interactions of individuals in various situations, ensuring that they align with the organization's values, societal norms, and legal requirements.

A Code of Conduct outlines the expected standards of behavior, integrity, and professionalism that individuals should uphold in their roles and responsibilities. It typically covers a wide range of topics, including honesty, respect, fairness, confidentiality, conflict of interest, compliance with laws and regulations, treatment of colleagues and stakeholders, and responsible use of resources.

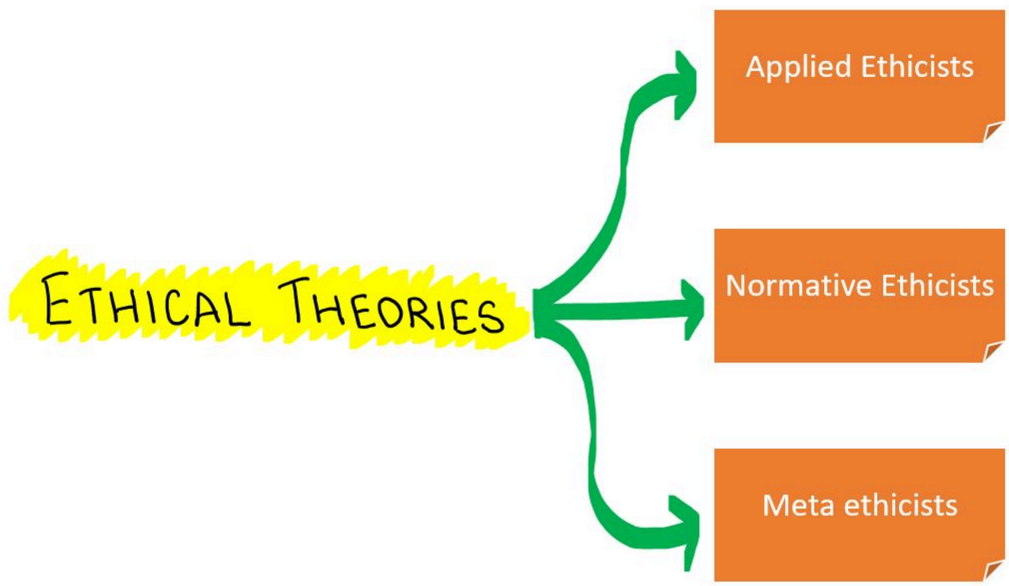
The primary objectives of a Code of Conduct are:

- *Ethical Guidance:* It provides clear and consistent guidance to individuals regarding ethical and acceptable behavior within the context of their roles and the organization's culture.
- *Decision-Making:* The code assists individuals in making ethical decisions by offering a set of principles and values to consider when faced with dilemmas or challenging situations.
- *Cultural Alignment:* It helps align the actions of individuals with the organization's mission, vision, and values, fostering a cohesive organizational culture.
- *Stakeholder Trust:* By adhering to the code, individuals and the organization as a whole can build and maintain trust with stakeholders, including customers, clients, employees, investors, and the public.
- *Legal and Regulatory Compliance:* A well-defined Code of Conduct ensures that individuals are aware of and comply with laws, regulations, and industry standards relevant to their roles.
- *Risk Management:* It assists in mitigating potential risks, conflicts of interest, and unethical behavior that could harm the organization's reputation or financial well-being.
- *Accountability:* The code establishes a basis for holding individuals accountable for their actions and decisions, providing a reference point for addressing violations.

A comprehensive Code of Conduct is tailored to the specific context and needs of the organization. It may include specific scenarios, examples, and procedures for reporting violations. The code should be communicated effectively to all individuals within the organization and integrated into employee training, orientation programs, and ongoing professional development.

3. Ethical Theories

Ethical theories are broadly classified into three main subject areas: metaethics, normative ethics, and applied ethics.



To illustrate these distinctions, consider the analogy of a football game, where different aspects of the game correspond to each discipline of ethics.

Firstly, we have the players on the field, akin to **applied ethicists**. These players delve into moral inquiries concerning specific issues, much like debating whether having an abortion is morally wrong, if human cloning is ethically acceptable, or whether there's an obligation to donate money. Applied ethicists focus on addressing particular moral quandaries and navigating ethical challenges akin to players maneuvering during a game.

Secondly, there's the referee, whose role is to interpret and enforce the rules of the game, analogous to **normative ethicists**. Just as the referee clarifies the rules guiding players' actions, normative ethicists examine the fundamental principles that underlie ethical decisions. They delve into questions such as whether consequences alone should determine right or wrong actions or what virtues and traits define moral character.

Lastly, the football analyst observes and comments on the dynamics and strategies within the game itself. This role parallels **metaethicists**, who don't actively partake in ethical decision-making or rule interpretation but instead scrutinize the practice of ethics itself. Metaethicists ponder the nature of ethical concepts, exploring questions about the essence of morality, the source of ethical truths, and the language and meaning of moral statements.

For instance, an applied ethicist might focus on debating the moral implications of environmental conservation, a normative ethicist might examine the underlying principles guiding conservation ethics, while a metaethicist might investigate the nature of moral language and the concept of ethical truths in environmental debates.

3. Ethical Theories

Metaethics is an enquiry into the nature and meaning of our moral judgements and actions. The aim of metaethics is to investigate where ethical principles come from, and what they mean. For example, when we say, Honesty is good, then what we want to say, or in other words, what do we mean when we use the term good in a moral judgement.It takes a bird's-eye view on the ethical practices as metaethicists go deep into the fundamental questions of morality and try to make sense of what is going on. Thus, one should not think of metaethics as something beyond or distant from ethics instead it is more fundamental and goes even deeper to the basic question of what morality itself is.

Metaethics deals with following questions: Are there moral facts? If there are moral facts, what is their origin? And how do we learn about the moral facts, if there are any? What do exactly people mean when they use the words like "good" and "right"? Where do moral values come from—what is their source and foundation? Are some things morally right or wrong for all people at all times, or does morality instead vary from person to person, context to context, or culture to culture?

3. Ethical Theories

Normative ethics deals with the formulation and evaluation of specific moral principles and theories that guide human behavior. It provides frameworks for determining what is morally right or wrong, good or bad. Normative ethics seeks to establish general principles and rules that individuals and societies should follow to make ethical decisions. Normative ethics provides guidance on how to make moral judgments and actions in various situations.

The key assumption in normative ethics is that there is only *one* ultimate criterion of moral conduct, whether it is a single rule or a set of principles.

In normative ethics, deontology is an example that emphasizes the moral duty to follow specific rules regardless of consequences. For instance, consider a deontological approach to truth-telling in which honesty is considered an absolute moral obligation. In a scenario where a person faces potential harm due to disclosing the truth, a deontological perspective insists on prioritizing the duty to tell the truth over the potential consequences, asserting that honesty is inherently valuable and must be upheld as a moral principle.

Three distinct strategies are recognized in this context: (i) virtue theories, (ii) duty theories, and (iii) consequentialist theories.

(i) Virtue Theories

Virtue ethical theory, associated with the ancient Greek philosopher **Aristotle**, employs the term "virtue" to convey moral obligations. Virtue is characterized as a disposition of character or personality that individuals desire within themselves and others. This perspective is also referred to as the **Theological Approach.**

While numerous philosophers assert that morality is guided by precisely defined rules of conduct, such as "do not kill" or "do not steal," virtue ethics places lesser emphasis on rule-learning. Instead, it underscores the significance of cultivating positive character habits, like benevolence. Once qualities like benevolence are cultivated, individuals are inclined to act habitually in alignment with them.

Plato notably highlighted 4 virtues, subsequently termed cardinal virtues: wisdom, courage, temperance, and justice. Additional virtues of importance encompass fortitude, generosity, self-respect, equanimity, and sincerity.

In addition to promoting virtuous character traits, virtue theorists advocate the avoidance of negative traits, or vices, like cowardice, insensitivity, injustice, and vanity. Moral education is a focal point of virtue theory, as virtuous traits are typically nurtured during youth. Consequently, adults bear the responsibility of instilling virtues in the younger generation.

(ii) Duty Theories

This approach is championed by figures like **Immanuel Kant, W. D. Ross,** and **John Rawls.** Duty theories are grounded in the notion of specific, foundational obligations, such as caring for our children and refraining from committing murder.

Morality, in this context, is derived from fundamental principles of duty. These theories are often referred to as deontological, stemming from the Greek term "deon," which signifies duty. They are also known as **non-consequentialist** since these principles are binding irrespective of the outcomes of actions. For instance, neglecting to care for our children is deemed wrong, even if it yields significant benefits, such as financial savings.

(iii) Consequentialist Theories

Many of us gauge our moral responsibilities by assessing the consequences of our actions. According to consequentialism, the correctness of moral conduct hinges solely on a cost-benefit evaluation of the outcomes. Consequentialism posits that an action is morally right if its consequences are more favorable than unfavorable. Prominent proponents of Consequentialist Theories include **Thrasymacus, Thomas Hobbes,** and **Ayn Rand.**

Within consequentialist normative principles, two steps are crucial. First, both the positive and negative consequences of an action are tallied. Second, it is determined whether the overall positive consequences outweigh the negative ones. If the positive consequences prevail, the action is morally justifiable; if the negative consequences outweigh the positive, the action is morally inappropriate.

Consequentialist theories are occasionally termed **teleological theories**, referencing the Greek term "telos," signifying end or purpose, as the final outcome of an action serves as the sole determinant of its morality.

Consequentialism can be further subdivided into 3 categories:

- **Ethical Egoism:** An action is morally right if its consequences are more favorable than unfavorable solely for the agent performing the action.
- **Ethical Altruism:** An action is morally right if its consequences are more favorable than unfavorable for everyone except the agent.
- **Utilitarianism:** An action is morally right if its consequences are more favorable than unfavorable for everyone.

---

3. Ethical Theories

Applied ethics involves the application of ethical principles and theories to real-world situations and specific issues. It addresses ethical dilemmas in various fields such as medicine, business, politics, environment, and technology. Applied ethics seeks to provide practical solutions and ethical guidelines for addressing complex moral issues. It involves analyzing the ethical implications of actions, policies, and decisions in specific contexts and recommending courses of action based on ethical principles.

For example, in the field of medicine, applied ethics plays a crucial role in addressing dilemmas such as end-of-life decisions. Applied ethics in this context involves evaluating the patient's wishes, weighing the potential benefits and harms of continued treatment, and making decisions that align with ethical principles and the best interests of the patient.

---

4. Approaches of Ethics

There are various ethical approaches each offering distinct perspectives on moral decision-making. These are discussed below.

Utilitarian Approach

Doing what's right means creating the most good or the least harm. In business, it's about making choices that benefit everyone – customers, employees, shareholders, and the environment. In tough situations, it aims to maximize positive outcomes while minimizing harm.

Rights Approach

Ethical actions respect the moral rights of individuals. This perspective is based on the idea that every person has fundamental rights, like the right to choose, privacy, and non-injury. It emphasizes that having rights also means having duties to respect the rights of others.

Fairness or Justice Approach

This approach focuses on treating everyone fairly based on a just standard. It questions salary disparities and seeks to ensure that compensation and opportunities are distributed equitably, aligning with contributions.

Common Good Approach

Actions should contribute to the well-being of the community. This perspective values communal life and emphasizes the importance of social conditions that benefit everyone, including laws, public services, healthcare, and education.

Virtue Approach

Doing what's right involves cultivating positive qualities, or virtues, like honesty, compassion, and fairness. It prompts individuals to ask, "What kind of person do I want to be?" and encourages the development of virtues that guide ethical behavior.

Kantian Approach

This approach focuses on performing one's duties without personal motives. It emphasizes fulfilling specific duties regardless of personal gain. For example, a mother caring for her child or a professional maintaining confidentiality out of duty.

5. Ethical Dilemma and Decision-Making

An ethical dilemma happens when you have to choose between options that are equally not good or seem to be in conflict. It's like facing the challenge of picking the best course of action when all the options have some problems or when different values are at odds.

These situations can come up for various reasons, like personal flaws, conflicts between personal values and what the organization wants, clashes between what the organization aims for and what society values, and more.

In the business world, a dilemma shows up when someone in a company has to decide between different options that affect how the company makes money and competes, as well as how it treats its stakeholders. When this happens, it's important to think carefully and make a decision that considers everything.

How to Address Ethical Dilemma

Dealing with an ethical dilemma involves these steps:

1. List all the possible actions you can take.

2. Think about the positive and negative outcomes of each action.

3. Look at the actions from different angles, focusing on the actions themselves and how they match up with ethical principles like honesty, fairness, equality, and considering societal and environmental concerns.

4. Make a thoughtful decision based on your analysis. Carry out the chosen decision and take responsibility for it. The decision should align with the company's goals, culture, values, and the values of the individuals involved.

5. Reflect on what caused the dilemma and try to fix the factors that contributed to it.

6. Moral Development

Moral development encompasses the progressive growth and refinement of an individual's comprehension of ethical principles and values. It represents a continuous journey from elementary and concrete notions of right and wrong towards more intricate and abstract perspectives. This concept draws heavily from moral psychology theories, particularly the pioneering work of psychologists like Lawrence Kohlberg and Jean Piaget.

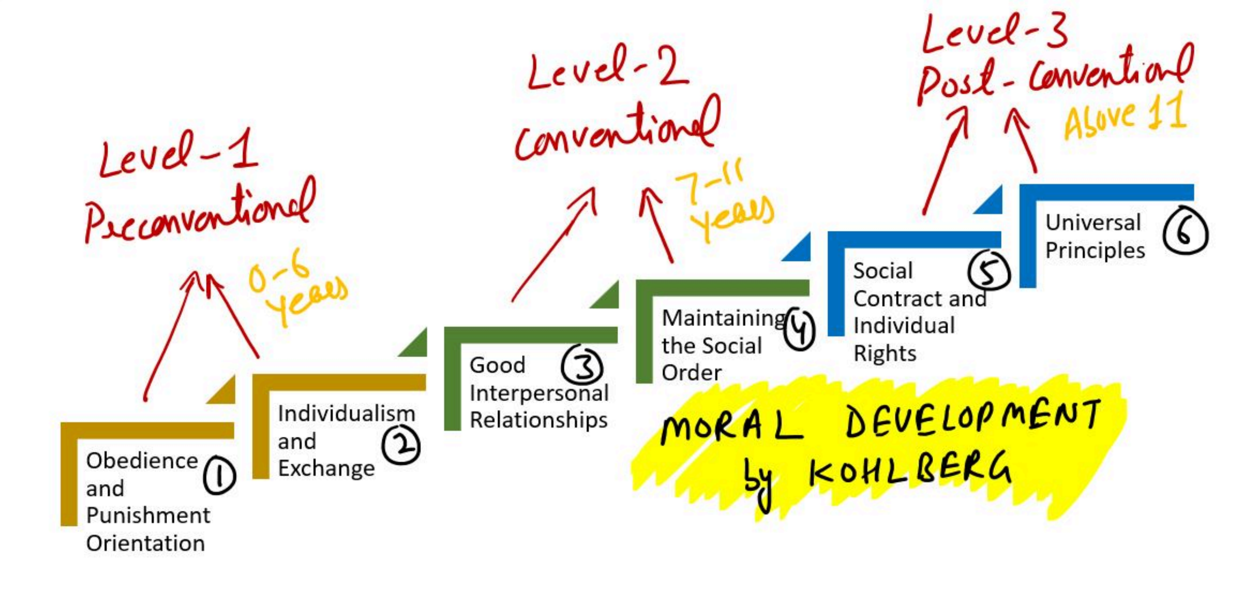
Numerous factors shape moral development, including cultural upbringing, social interactions, educational environments, and exposure to diverse viewpoints. It profoundly influences individuals' ethical decision-making processes, significantly impacting their conduct across personal, social, and professional realms.

7. Theories of Moral Development

Following theories of Moral Development are discussed next.

1. Kohlberg's stages of Moral Development, and
2. Moral Development Theory of James Rest.

7. Theories of Moral Development



Moral development refers to the process whereby people form a progressive sense of what is right and wrong, proper and improper. As implied by the term development, human moral sense is commonly seen to involve a movement from simple and finite definitions of right and wrong to more complex ways of distinguishing right from wrong.

Kohlberg identified 3 distinct levels of moral reasoning each with 2 sub-stages. People can only pass through these levels in the order listed. Each new stage replaces the reasoning typical of the earlier stage. Not everyone achieves all the stages.

Level 1 - Pre-conventional morality

At the pre-conventional level (most 9-year-old and younger, some over 9), we don't have a personal code of morality. Instead, our moral code is shaped by the standards of adults and the consequences of following or breaking their rules. Authority is outside the individual and reasoning is based on the physical consequences of actions.

Stage 1: Obedience and Punishment Orientation. The child/individual is good in order to avoid being punished. If a person is punished, they must have done wrong.

Stage 2: Individualism and Exchange. At this stage, children recognize that there is not just one right view that is handed down by the authorities. Different individuals have different viewpoints.

Level 2 - Conventional morality

At the conventional level (most adolescents and adults), we begin to internalize the moral standards of valued adult role models. Authority is internalized but not questioned, and reasoning is based on the norms of the group to which the person belongs.

Stage 3: Good Interpersonal Relationships. The child/individual is good in order to be seen as being a good person by others. Therefore, answers relate to the approval of others.

Stage 4: Maintaining the Social Order. The child/individual becomes aware of the wider rules of society, so judgments concern obeying the rules in order to uphold the law and to avoid guilt.

Level 3 - Post-conventional morality

Individual judgment is based on self-chosen principles, and moral reasoning is based on individual rights and justice. According to Kohlberg, this level of moral reasoning is as far as most people get. Only 10-15% are capable of the kind of abstract thinking necessary for stage 5 or 6 (post-conventional morality). That is to say, most people take their moral views from those around them and only a minority think through ethical principles for themselves.

Stage 5: Social Contract and Individual Rights. The child/individual becomes aware that while rules/laws might exist for the good of the greatest number, there are times when they will work against the interest of particular individuals.

The issues are not always clear-cut. For example, in Heinz's dilemma, the protection of life is more important than breaking the law against stealing.

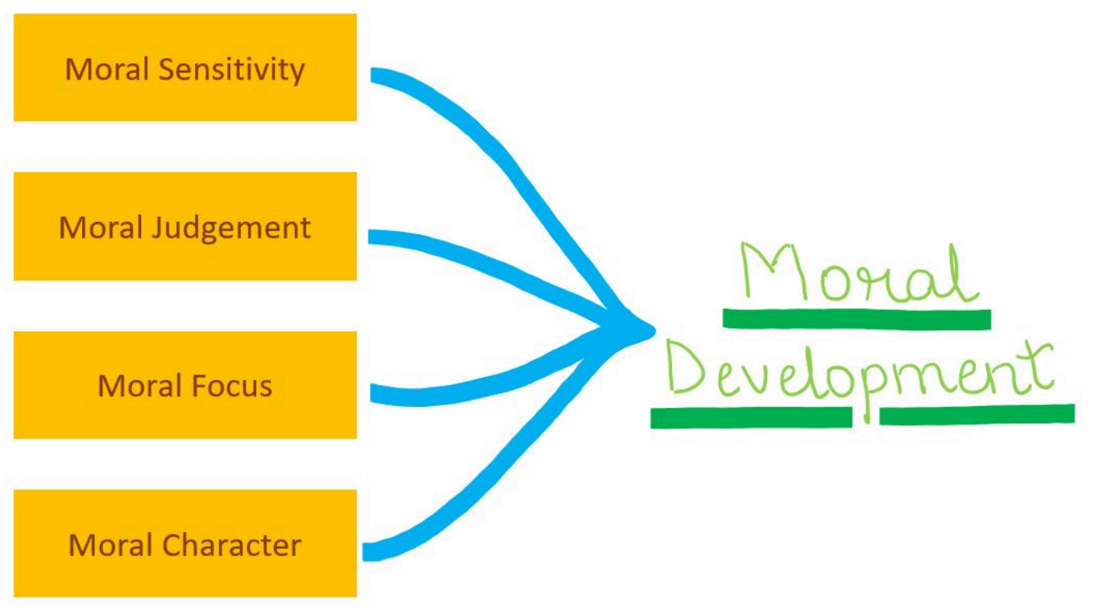
Stage 6: Universal Principles. People at this stage have developed their own set of moral guidelines, which may or may not fit the law. The principles apply to everyone.

For example, human rights, justice, and equality. The person will be prepared to act to defend these principles, even if it means going against the rest of society in the process and having to pay the consequences of disapproval and/ or imprisonment. Kohlberg doubted few people reached this stage.

---

7. Theories of Moral Development

James Rest's studies center directly on moral development in the context of formal education.



He proposed a 4 component model suggesting various inner psychological processes, which together give way to observable behavior.

1. **Moral Sensitivity:** The first component of the process starts with a recognition that a moral problem or opportunity exists.
2. **Moral Judgment:** The second component of the model is moral judgment. It involves the individual making a judgment concerning which course of action is morally right and which course of action is morally wrong.
3. **Moral Focus (Moral Intention):** The third component of the model is moral focus. This one is also known as moral intention, which involves the individual prioritizing choices in response to a given situation.
4. **Moral Character:** The final component of the model is moral character. This component involves executing and implementing a morally-based course of action. During this stage, individuals carry out their intentions by keeping the goals and outcomes of their chosen course of action in mind.

Rest asserts that, when confronted with an ethical dilemma, individuals engage in a decision-making process that involves working through these four components. Individuals move from moral awareness, the recognition of a moral situation, to moral judgment, the evaluation of choices and outcomes, to moral intention, choosing how one intends to act, and lastly to moral action, the actual behavior in the situation. A failure at any step in the process could result in a failure to make an ethical decision.

---

8. Values-Based Organization

A value-based organization is one that places a strong emphasis on a set of core values that guide its actions, decisions, and interactions both internally and externally. These core values form the foundation of the organization's culture, shaping its identity and influencing how it operates. A value-based organization ensures that its actions and behaviors are aligned with these values, promoting a consistent and ethical approach to business practices.

Key characteristics of a value-based organization include:

- *Clear Core Values:* A value-based organization identifies and defines a set of core values that reflect its principles, beliefs, and ethical standards. These values serve as guiding principles for all aspects of the organization's operations.
- *Integration into Culture:* Core values are deeply integrated into the organizational culture. They are not merely words on a poster but are lived and practiced by every member of the organization.
- *Decision-Making:* Core values play a significant role in decision-making processes. Leaders and employees use these values as a compass to make ethical and consistent choices, especially in complex or challenging situations.
- *Alignment:* The organization ensures that its values are aligned with its mission, vision, and long-term goals. Values act as a moral compass that guides the organization toward its strategic objectives.
- *Employee Engagement:* Employees are not only aware of the core values but also actively engage with them. They understand how their work contributes to upholding these values and creating a positive impact.
- *Customer Relationships:* Values influence how the organization interacts with its customers, suppliers, and stakeholders. Ethical behavior, transparency, and respect are fundamental components of these interactions.
- *Leadership Example:* Leaders within a value-based organization set an example by consistently demonstrating the core values in their actions and decisions. This encourages others to follow suit.
- *Ethical Conduct:* Ethical conduct is paramount within a value-based organization. The core values guide employees to act ethically and responsibly, both internally and in external relationships.
- *Adaptability:* While core values remain constant, a value-based organization is also adaptable to changing circumstances. It assesses whether its values remain relevant and meaningful over time.
- *Trust and Reputation:* A strong adherence to core values fosters trust among employees, customers, and stakeholders. This trust contributes to a positive reputation and sustained success.

A technology company may identify core values such as innovation, integrity, collaboration, and customer focus. These values guide the company's product development, interactions with customers, and relationships with employees. For instance, when deciding on new product features, the company's commitment to innovation and customer focus ensures that customer needs are met with creative solutions. When faced with a challenge, employees make decisions that uphold integrity and collaborate to find ethical resolutions. Over time, the organization's reputation as an innovative and trustworthy company is built on these core values.

---

1. Introduction

Over the centuries, accounting was mainly focused on recording financial transactions. However, in today's fast-changing business environment, accountants have had to reassess their roles.

Today, accounting goes beyond just keeping records and making financial reports. Accountants now work in exciting new fields like forensic accounting (solving crimes like computer hacking and online money theft), e-commerce (creating web-based payment systems), financial planning, and environmental accounting. This shift happened because accounting can provide crucial information for managers and others to make better decisions. Over time, accounting has become so important that it's now seen as an information system that gathers and shares economic data about an organization with various users who rely on it to make decisions.

In other words, Accounting aims to provide information that helps people make smart decisions. That's why it's often called the **language of business**.

---

2. Definition of Accounting

In 1941, the **American Institute of Certified Public Accountants** (AICPA) described accounting as the skill of recording, organizing, and summarizing transactions and events that have financial value, all in terms of money, and making sense of the results.

As the economy grew and changed, the role of accounting expanded. In 1966, the **American Accounting Association** (AAA) defined accounting as the process of identifying, measuring, and sharing economic information so that people can make informed decisions.

In 1970, the **Accounting Principles Board** of the AICPA emphasized that accounting's main job is to provide useful financial information about businesses to help in making economic decisions.

So, **accounting can be simply defined** as the process of identifying, measuring, recording, and sharing information about an organization's financial activities with those who need it.

In order to appreciate the exact nature of accounting, we must understand the following relevant aspects of the definition:
1. Economic Events
2. Process of Accounting
3. Organisation
4. Users of Accounting Information

These are discussed next one by one.

---

2. Definition of Accounting

An economic event refers to any activity or transaction that affects a company's financial statements. These events involve the exchange or movement of value, such as money, goods, or services, and they are recorded in the company's books because they have an impact on its financial position.

Examples of economic events include:

- *Sales:* Selling products or services to customers.
- *Purchases:* Buying goods or services for the business.
- *Payments:* Paying salaries, rent, or other expenses.
- *Investments:* Putting money into new assets, like equipment or stocks.

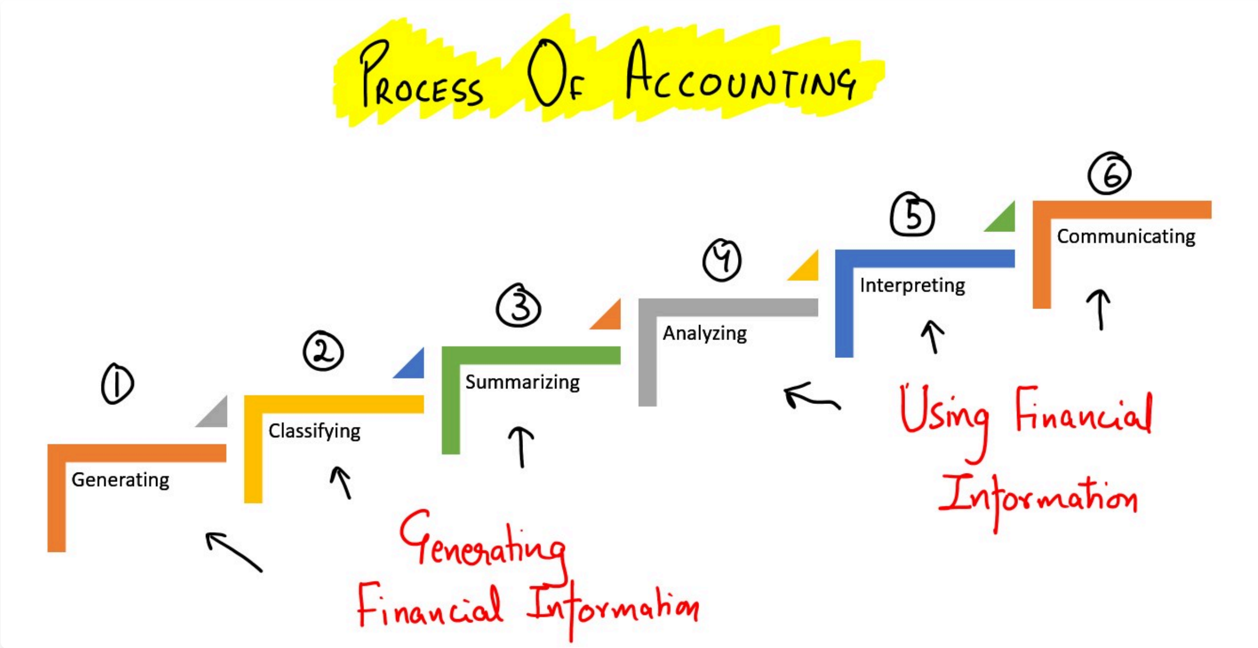
These events are classified into external events and internal events.

1. External Events
If an event involves transactions between an outsider and an organisation, these are known as external events. For example, sale of merchandise to the customers, Rendering services to the customers by the Company, purchase of materials from suppliers, monthly rent payments etc.

2. Internal Events
An internal event is an economic event that occurs entirely between the internal wings of an enterprise, e.g., supply of raw material or components by the stores department to the manufacturing department, payment of wages to the employees, etc.

---

2. Definition of Accounting



The characteristics and essence of accounting can be illustrated by examining its procedural aspects. The process of accounting can be divided into 2 parts involving following steps.

I. Generating financial information

Step 1: Recording all the financial transactions of business nature in primary books such as Journal, Cashbook, Purchase book, Sales Book, etc.

Step 2: Classifying the above recorded data with a view to group together information of similar nature at one place to put information in compact and useable form. The book containing classified information are called **ledgers**.

Step 3: Summarizing all the classified data in a useful manner for preparing and presenting the financial statements at the end of the year.

II. Using the financial information

Step 4: Analysing the financial statements with the help of various tools and techniques.

Step 5: Interpreting the information made available after analysing the financial statements into simple meaningful information.

Step 6: Communicating the summarized, analysed and interpreted information to the end user for rational decision making.

Thus, accounting may be defined as the process of recording, classifying, summarising, analysing and interpreting the financial transactions and communicating the results thereof to the persons interested in such information.

---

2. Definition of Accounting

An organization refers to the business entity itself, which could be for-profit or not-for-profit. Depending upon the size of activities and level of business operation, it can be a sole-proprietary concern, partnership firm, cooperative society, company, local authority, municipal corporation or any other association of persons.

---

2. Definition of Accounting

Many users need financial information in order to make important decisions. These users can be divided into two broad categories: internal users and external users.

Internal Users

1. Owners-Shareholders

Owners and shareholders are the primary stakeholders of a company. They provide capital and have a vested interest in the financial health and performance of the business.

Owners rely on accounting information to assess the profitability, liquidity, and overall financial position of the company. They use financial statements such as the balance sheet, income statement, and cash flow statement to evaluate the return on their investment, make investment decisions, and assess the company's ability to generate future profits and dividends.

2. Management

Internal management, including executives and operational managers, is responsible for making strategic decisions and managing day-to-day operations.

Management uses accounting data for various purposes, including strategic planning, budgeting, performance evaluation, and decision-making. Financial reports provide insights into revenue generation, cost management, profitability analysis, and cash flow management. Management relies on accounting information to monitor financial performance, identify areas for improvement, allocate resources effectively, and set future goals and targets.

External Users

1. Employees

Employees are interested in the financial stability and viability of the company, as it impacts job security, compensation, and career advancement opportunities.

Employees may use financial statements to assess the company's financial health, stability, and growth prospects. They may also analyze financial data to evaluate the company's ability to honor employee benefits, salaries, and other obligations.

2. Banks and Financial Institutions (FIs)

Banks and financial institutions provide financing and credit facilities to businesses and individuals.

Lenders use financial statements to assess the creditworthiness and risk profile of a company before extending loans or credit facilities. They analyze financial ratios, liquidity positions, and debt levels to evaluate repayment capacity and determine the terms and conditions of lending.

3. Potential Investors

Potential investors, including individual investors, institutional investors, and venture capitalists, evaluate investment opportunities based on financial performance and growth potential.

Investors analyze financial reports to assess the company's profitability, liquidity, solvency, and valuation metrics. They use financial data to make investment decisions, estimate future cash flows, and evaluate the company's risk-return profile.

4. Creditors

Creditors, such as suppliers and trade creditors, extend credit to the company in the form of trade credit or loans.

Creditors use financial statements to assess the creditworthiness and repayment capacity of the company. They analyze financial ratios, working capital positions, and payment histories to evaluate credit risk and determine credit terms.

5. Government and Regulatory Bodies

Government agencies and regulatory bodies oversee financial reporting standards, taxation laws, and regulatory compliance.

Regulatory authorities use financial reports to ensure compliance with accounting standards, taxation laws, and disclosure requirements. They monitor financial statements to detect fraud, assess corporate governance practices, and protect investor interests.

6. Public

The general public, including customers, suppliers, and competitors, may have an interest in the financial affairs and reputation of the company.

Stakeholders outside the organization may use financial information to assess the company's stability, ethical practices, and reputation. They may analyze financial reports to evaluate product quality, customer satisfaction, and corporate social responsibility initiatives.

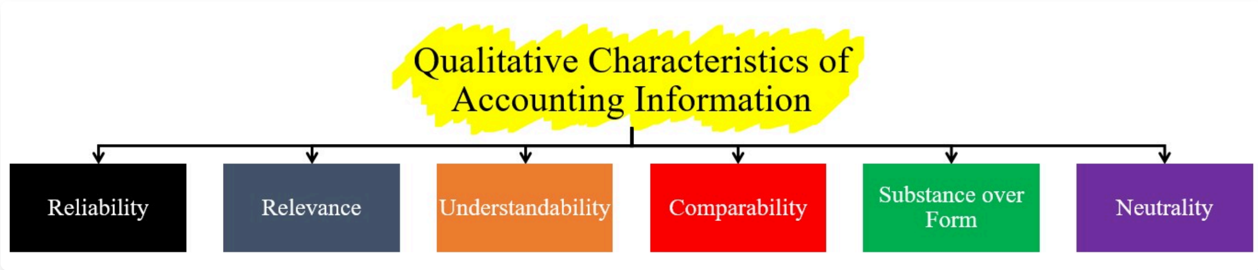
7. Researchers

Researchers, academics, and industry analysts conduct studies and research projects to analyze financial markets, trends, and business performance.

Researchers use financial data for academic research, market analysis, and trend forecasting. They may analyze financial statements to identify patterns, correlations, and anomalies in financial data and contribute to the advancement of knowledge in accounting and finance.

3. Qualitative Characteristics of Accounting Information

Qualitative characteristics are the attributes of accounting information which tend to enhance its understandability and usefulness.



In order to ensure usefulness, the accounting information must possess following qualitative characteristics:

1. Reliability

Information should be free from error and bias and should faithfully represent what it is meant to represent. Information should be such that users can depend on it to take informed decisions. To ensure reliability, the information must be credible and verifiable by independent parties.

2. Relevance

For information to be relevant, it should be timely, help with predictions and feedback, and impact decisions by:
(a) helping predict what will happen in the past, present, or future; and/or
(b) confirming or correcting past judgments.

3. Understandability

Understandability means decision-makers must interpret accounting information in the same sense as it is prepared and conveyed to them. Accountants should present the comparable information in the most intelligible manner without sacrificing relevance and reliability.

4. Comparability

It is important that the users can compare various aspects of an entity over different time period, known as *intra-firm comparison* and with other entities in the industry, known as *inter-firm comparison*.To be comparable, accounting reports must belong to a common period and use common unit of measurement and format of reporting.

5. Substance over Form

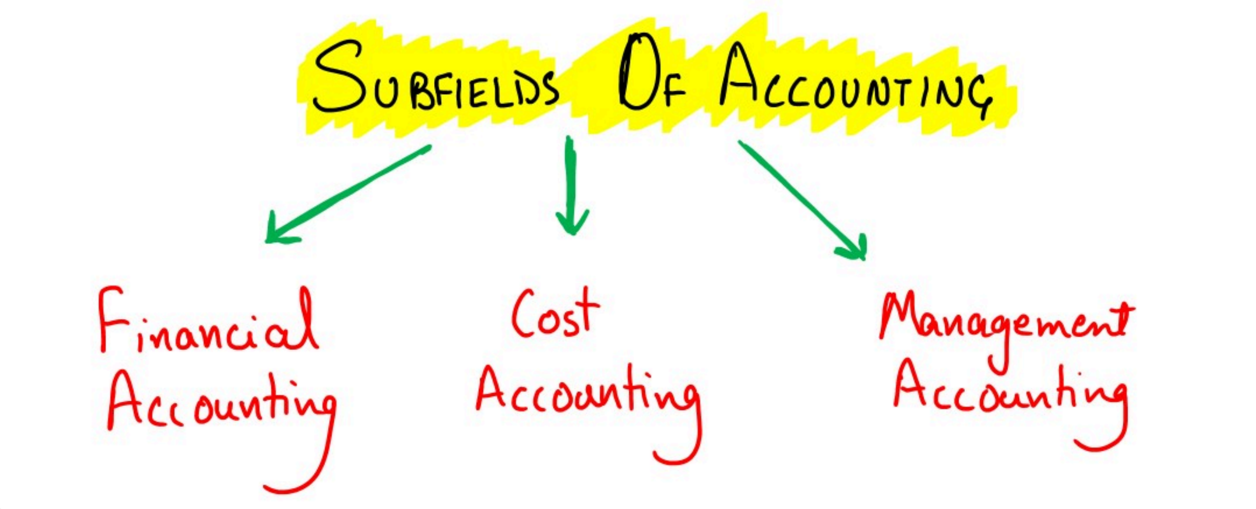
It means that the economic substance of transactions and events must be recorded in the financial statements rather than just their legal form. It is done in order to present a true and fair view of the affairs of the entity. For example, if a firm has sold its land and building, received the consideration and handed over the possession to the buyer, it should be recorded as sale of land and building in the books of the firm. This recognition cannot be postponed for mere procedural formality pending, such as registration of sale deed.

6. Neutrality

Neutrality means that financial information should be presented fairly and impartially, without bias or favoritism. Neutrality ensures that financial information is trustworthy and gives all users a clear, unbiased view of a company's financial health.

4. Branches of Accounting

The apparently divergent needs of internal and external users of accounting information have resulted in the development of sub-disciplines within the accounting discipline namely, financial accounting, cost accounting and management accounting.



1. Financial Accounting

Financial Accounting covers the presentation and interpretation of financial statements and communicating it to the users of accounts. It relates to the past period or we can say, it is historical in nature, as its records transactions which have already occurred. It serves the stewardship function. In other words, financial accounting ensures that the management of resources is transparent and accountable to stakeholders, demonstrating how resources are utilized and managed. It is monetary in nature because it focuses on recording, measuring, and reporting financial transactions in terms of money.

This branch of accounting aims to record all financial transactions so that:
(a) the profit or loss for the business during an accounting period can be determined,
(b) the financial position of the business at the end of the accounting period can be assessed, and
(c) financial information needed by management and other stakeholders can be provided.

2. Cost Accounting

Cost accounting assists in analysing the expenditure for ascertaining the cost of various products manufactured or services rendered by the firm and fixation of prices thereof. It also helps in controlling the costs and providing necessary costing information to management for decision-making.

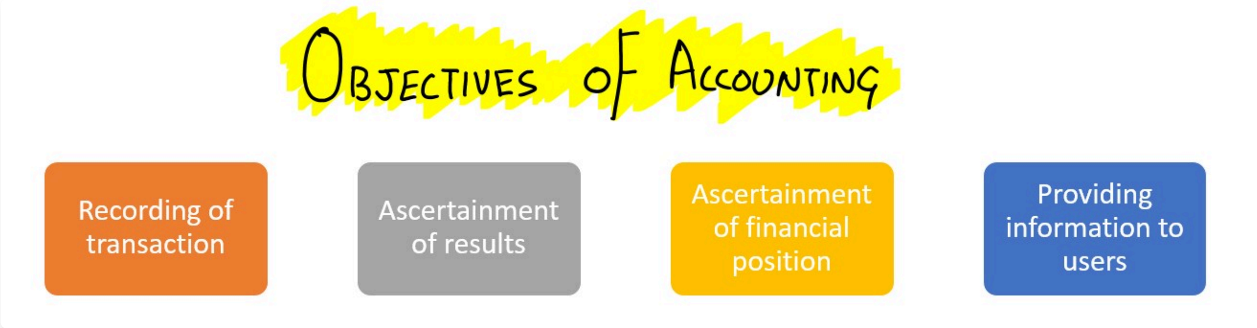
3. Management Accounting

Management accounting provides essential accounting information to internal stakeholders to support decision-making, planning, and control of business operations. It primarily utilizes data from financial accounting and cost accounting to assist in budgeting, evaluating profitability, setting prices, making capital expenditure decisions, and more. Additionally, management accounting generates both quantitative and qualitative information, covering financial and non-financial aspects, that is forward-looking and critical for organizational decision-making. This includes forecasts of sales, cash flow projections, purchase requirements, manpower needs, and environmental data related to air, water, land, natural resources, flora, fauna, human health, and social responsibilities.

The purpose of management accounting is to support management in making informed decisions and assessing the effects of those decisions and actions.

5. Objectives of Accounting

As an information system, the main goal of accounting is to provide valuable information to both internal and external users. For external users, this information is presented through financial statements, such as the profit and loss account and balance sheet. Additionally, management receives supplementary information from the business's accounting records.



The primary objectives of accounting include:

1. Maintaining Records of Business Transactions
Accounting systematically records all financial transactions in the books. Since it is challenging for even the most capable executive or manager to remember every transaction—such as purchases, sales, receipts, and payments—keeping accurate and comprehensive records is essential. These records provide verifiability and serve as evidence.

2. Calculating Profit and Loss
Business owners need to know periodically whether their business is profitable or has incurred losses. Accounting helps determine the profit or loss for a given period by tracking income and expenses and preparing a profit and loss account. Profit is calculated as the excess of revenue over expenses. For example, if revenue is Rs. 10,00,000 and expenses are Rs.7,40,000, the profit is Rs. 2,60,000 (Rs. 10,00,000 - Rs.7,40,000). If expenses exceed revenue, the result is a loss.

3. Depicting Financial Position
Accounting also determines the business's financial position at the end of each accounting period, showing its assets and liabilities. A detailed record of assets (resources owned by the business) and liabilities (claims against these resources) allows the preparation of a balance sheet, which reflects the business's financial position.

4. Providing Accounting Information to Users
The accounting information produced is shared with users in various formats, including reports, statements, graphs, and charts. Internal users, mainly management, need timely data on costs, profitability, and other aspects for planning and decision-making. External users, who have limited access to detailed information, rely on financial statements.

Key external users include:

- *Investors and Potential Investors:* Interested in risks and returns on their investments.
- *Unions and Employee Groups:* Seek information on the business's stability, profitability, and wealth distribution.
- *Lenders and Financial Institutions:* Evaluate the company's creditworthiness and ability to repay loans.
- *Suppliers and Creditors:* Need to know if amounts owed will be repaid and if the business will continue to operate.
- *Customers:* Look for assurance that the business will continue to supply products and services.
- *Government and Regulators:* Monitor resource allocation and compliance with regulations.
- *Social Responsibility Groups:* Concerned with the business's environmental impact and protection efforts.
- *Competitors:* Use the information for strategic planning and benchmarking against their own performance.

Each of these users requires accounting information for different purposes, ranging from investment decisions to competitive analysis.

6. Role of Accounting

Over the centuries, the role of accounting has evolved alongside economic development and shifting societal needs. Accounting involves measuring, classifying, and summarizing vast amounts of data from an enterprise, and then presenting this data in reports and statements that reflect the organization's financial status and operational results. Because of this, accounting is often called the "language of business." It also provides valuable quantitative financial information that assists users in various ways. As an information system, accounting gathers and shares economic information about an enterprise with many interested parties. However, since accounting primarily deals with past transactions and focuses on quantitative financial data, it does not offer qualitative or non-financial information. These limitations should be considered when using accounting information.

Different Roles of Accounting

Accounting plays a multifaceted role in the business world, adapting to various needs and functions.

- *As a Language:* Accounting is seen as the business language used to communicate information about enterprises.
- *As a Historical Record:* It serves as a chronological record of an organization's financial transactions, detailing the actual amounts involved.
- *As Current Economic Reality:* Accounting helps determine an entity's true income by showing how wealth changes over time.
- *As an Information System:* It functions as a process connecting information sources (such as accountants) to recipients (external users) through communication channels.
- *As a Commodity:* Specialized accounting information is a sought-after service in society, with accountants ready and able to provide it.

7. Functions of Accounting

Accounting serves several crucial functions within organizations and society at large.

Firstly, it provides a systematic and organized way to record financial transactions, ensuring accuracy and transparency in business operations.

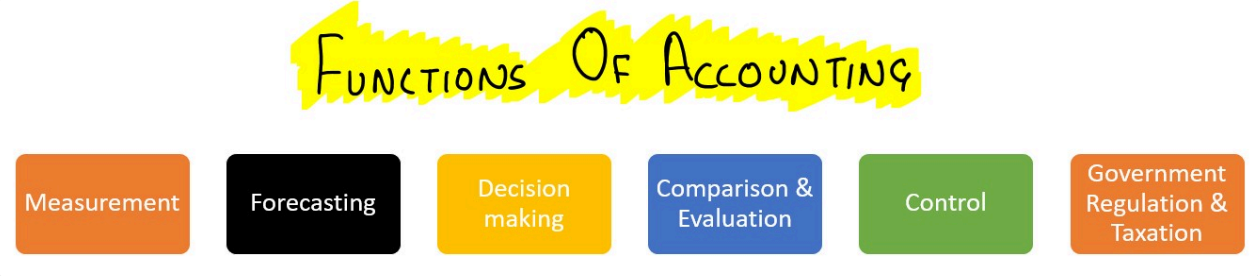
Secondly, it facilitates the preparation of financial statements, such as the income statement, balance sheet, and cash flow statement, which are essential for assessing the financial health and performance of a company.

Thirdly, accounting aids in decision-making by providing relevant financial information to management, investors, creditors, and other stakeholders.

Additionally, it plays a vital role in compliance with legal and regulatory requirements, ensuring that businesses adhere to accounting standards and taxation laws.

Moreover, accounting serves as a tool for monitoring and controlling expenses, identifying areas for cost reduction and efficiency improvement.

Overall, the functions of accounting extend beyond mere bookkeeping to encompass financial reporting, decision support, compliance, and managerial control.



The functions of Accounting are as follows:

1. Measuring
Accounting looks at what happened in the past in a business and shows how the business is doing financially right now.

2. Predicting
Accounting helps guess what might happen in the future by looking at what happened before and spotting trends.

3. Decision-making
Accounting gives useful info to people using the accounts, helping them make smart choices about the business.

4. Comparing & Evaluating
Accounting checks how well the business is doing compared to what it wanted to achieve, and it tells us about the rules used to keep track of money and any possible problems coming up.

5. Control
Accounting finds any weak spots in how the business operates and tells us if the things we're doing to fix them are working.

6. Legal Requirements
Courts of law recognize accounting records as credible evidence when they are meticulously maintained in accordance with established accounting principles and concepts. Moreover, various laws, including the Companies Act, Income Tax Act, and GST Act, mandate the timely submission of returns in specified formats and deadlines. Compliance with these legal requirements hinges on the systematic and punctual maintenance of accounting records, ensuring that accurate information is readily available for submission.

8. Limitations of Accounting

The language of accounting has certain practical limitations and, therefore, the financial statements should be interpreted carefully keeping in mind all various factors influencing the true picture. The assumptions and conventions, on which the accounting is based, become the limitations of accounting. The financial statements are never free from subjectivity factor as these are largely the outcome of personal judgement of the accountant with regard to the adoption of the accounting policies.

The limitations of accounting are as follows:

1. Accounting information is expressed in terms of money
Accounting measures only those events that are of financial nature i.e. capable of being expressed in terms of money. Non-monetary items or events which cannot be measured are not recorded in accounting.

For example, a company cannot record the value of employee satisfaction or brand reputation directly in its financial statements because these are not monetary items.

2. Accounting information is based on estimates
Some accounting data are based on estimates and some estimates may be inaccurate.

For example, estimating the useful life of machinery or the amount of bad debts that may occur in the future involves making educated guesses, which may not always be accurate.

3. Accounting information may be biased
Accounting information is not without personal influence or bias of the accountant. In measuring income, accountant has a choice between different methods of inventory valuation, depreciation methods, treatment of capital and revenue items etc. Hence, due to the lack of objectivity income arrived at may not be correct in certain cases.

For example, an accountant might choose a depreciation method that minimizes expenses to make the company's profits appear higher, even if another method would provide a more accurate reflection of the asset's value.

4. Fixed assets are recorded at the original cost
The values of fixed assets change over time and so there may be a great difference between the original cost and current replacement cost. Balance sheet may not show true and fair view of the financial position on a date.

For example, a company purchases machinery for Rs. 50,000, but its market value increases to Rs. 60,000 over time. However, in the balance sheet, the machinery will still be reported at its original cost of Rs. 50,000.

5. Accounting can be manipulated
Accounting information may not be used as the only means of testing of managerial performance, as profits can be manipulated or misrepresented.

For example, a company might delay recognizing expenses or accelerate recognizing revenue to artificially inflate its profits, giving a false impression of its financial health.

6. Money as a measurement unit changes in value
The value of money does not remain stable. Unless price level changes are considered in measurement of income, the accounting information will not show true financial results.

For example, if a company reports a profit of Rs.100,000 in a year of high inflation without adjusting for the decrease in the value of money, the real purchasing power of that profit may be lower than expected.

1. Basic Accounting Terms

In business, various accounting terms are used. It is necessary to understand these terms as they are part of the standard accounting terminology.

These accounting terms are explained next one by one.

---

2. Entity

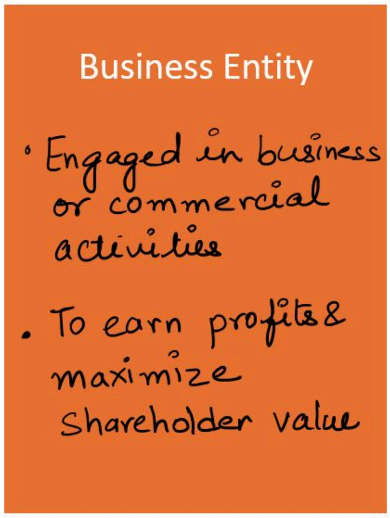
An entity is anything that exists independently and can be identified separately. In simple terms, it's something that has its own unique identity. In business, an entity could be a company, organization, or person that carries out activities like buying, selling, or providing services. For example, a shop, a school, or a person running their own business are all entities because they operate independently.

An entity can be a **business entity** or **non-business entity**.

These are explained next.

---

2. Entity



A business entity is a specific type of entity that is legally established to engage in commercial or business activities. These activities are conducted with the primary goal of earning profits and maximizing shareholder value. Business entities operate within a legal framework and are subject to regulatory requirements.

Examples include Tata Group, Infosys Limited, Reliance Industries Limited etc.

Each of these represents a distinct corporate structure with its own goals, strategies, and operations. They may vary in size, scope, and industry focus, but they all share the common objective of generating profits and creating value for their stakeholders.

---

2. Entity

A non-business entity, also known as a not-for-profit organization (NPO), is an entity that is established in accordance with the law but does not operate with the primary objective of making profits. Instead, these entities are dedicated to serving the public interest, promoting a cause, or providing services to members or beneficiaries.

Non-business entities often rely on donations, grants, and contributions to fund their activities.

Examples of non-business entities include charitable organizations like CARE India, humanitarian organizations like the Indian Red Cross Society, social clubs, educational institutions, sports associations, and religious organizations.

Additionally, social clubs, educational institutions, sports associations, and religious organizations are all examples of non-business entities, each with its own unique mission and objectives aimed at benefiting society or specific communities.

3. Business Transactions

A business transaction refers to any event or activity that involves the exchange of goods, services, or assets between two parties, resulting in a financial impact on the business. These transactions are recorded systematically to ensure accurate financial reporting and analysis.

Examples of common business transactions include:

- Sale of goods or services to customers
- Purchase of raw material from suppliers
- Payment of wages or salaries to employees
- Borrowing money from lenders or financial institutions
- Repayment of loans or payment of interest
- Acquisition or disposal of assets, such as property, equipment, or investments.

Some features of Business transactions are as follows:

- Business transactions must be financial in nature.
- Business transactions must be supported by documentary evidence.
- Business transactions must be presented in numerical monetary terms.
- Business transactions must cause an effect on assets, liabilities, capital, revenue and expenses.

4. Proprietor or Owner

'Proprietor' and 'owner' are terms often used interchangeably, particularly in the context of business. Both refer to individuals or groups of people who have legal ownership and control over a business entity.

A proprietor is an individual or a group of persons who undertake the risk of carrying on a business. This means they invest their resources, such as money, time, and effort, into starting and operating a business with the expectation of making a profit.

The term 'proprietor can be used in various contexts, including sole proprietorships, partnerships, and sometimes even in corporations where one individual or a small group holds significant control over the company.

Proprietors provide the necessary funds or capital to establish and run the business. This capital is used to purchase assets, such as equipment, inventory, and property, as well as to cover initial expenses like rent, utilities, and salaries.

Proprietors are responsible for organizing the factors of production—land, labor, capital, and entrepreneurship—to ensure the efficient operation of the business. This involves allocating resources effectively to produce goods or services and generate revenue.

In essence, a proprietor is the individual or group that assumes responsibility for the success or failure of the business. They make key decisions regarding operations, finances, and strategies, and they bear the risks associated with the business, such as financial losses, legal liabilities, and market uncertainties.

After meeting all the expenses of business, if there remains any surplus, it is known as profit. The proprietor is rewarded with profit for the risk undertaken by him. If expenses exceed revenue, the deficit is a loss to be borne by the proprietor. Thus, in case of profit, proprietor’s capital increases and in case of loss, the capital decreases.

5. Capital

Capital refers to the money or resources invested to start a business or to generate further income. It can come in various forms, such as cash, goods, or other assets like equipment or property. This initial investment is typically made by the business owner or proprietor.

For example, if someone starts a bakery, the capital might include the cash used to buy ingredients, the ovens, and the building itself.

Note that Capital is considered a liability for a business because it is money that the business owes to the owner. When the owner puts money or assets into the business, it creates a claim that the owner has on the business's resources. Even though this money helps run the business, it's recorded as a liability because it represents the owner's share that could be withdrawn or is owed to him.

---

6. Drawings

'Drawings' refer to the funds withdrawn or goods taken out of the business by the owner(s) for personal use. It represents the extraction of assets from the business by the proprietor or partner for their own benefit, rather than for business purposes.

Drawings involve the withdrawal of cash from the business's accounts by the owner(s) for personal expenses. This can include taking money out of the business's bank account or cash register to cover personal expenses.

In addition to cash, drawings can also involve the removal of goods or assets from the business for personal use. For example, a proprietor might take inventory items, equipment, or other assets from the business without proper compensation or accounting for their value.

Drawings are recorded as a reduction in the owner's equity in the business. Since the owner's equity represents the owner's stake in the business's assets after accounting for liabilities, drawings effectively decrease the owner's investment in the business.

---

7. Receipts

Receipts refer to the funds received by a business during a specific accounting period. These funds can come in various forms, including cash payments from customers, payments from debtors, proceeds from loans or credit lines, or funding from investors. Receipts represent incoming cash flow into the business and are recorded as part of the company's financial transactions.

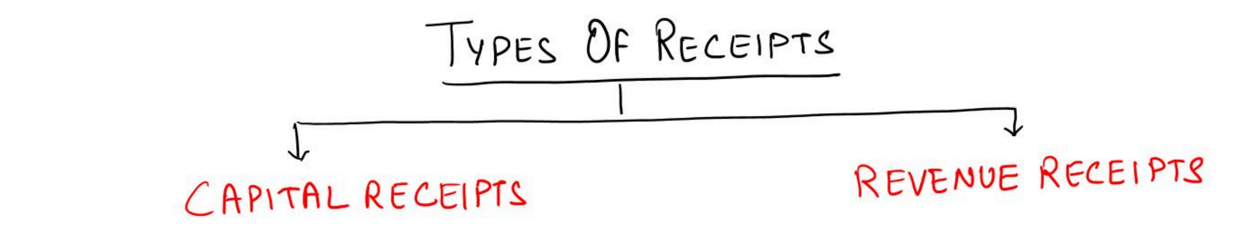
Here are the key components of receipts in accounting:

Cash Sales: Receipts include cash received from customers in exchange for goods or services sold by the business. When a customer pays for a product or service with cash, the amount received is recorded as a receipt.

Debtor Payments: Receipts also encompass payments received from debtors, which are individuals or entities that owe money to the business. These payments may include repayments of outstanding invoices, installment payments, or settlements of accounts receivable.

Other Sources of Cash: Receipts can originate from various sources other than sales or debtor payments. For example, a business may receive cash from a loan or credit line obtained from a financial institution. Additionally, receipts can include funding received from investors, such as equity investments or capital contributions.

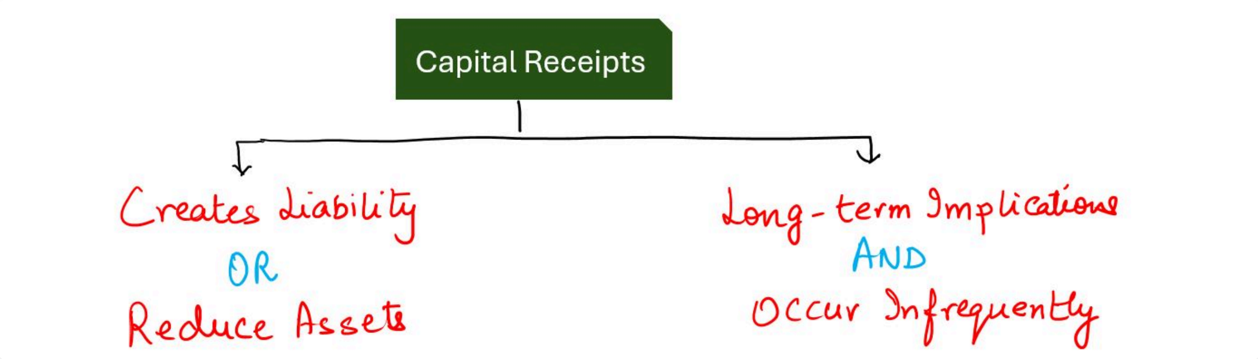
Receipts can be classified as follows:



These are discussed next.

7. Receipts

Capital receipts are a type of income or inflow of funds that either create a liability for the company or reduce its assets. These receipts involve transactions that have long-term implications for the company's financial position and are not part of its regular operating activities. Capital receipts are distinguished from revenue receipts, which represent income generated from the company's primary business operations.



Examples of capital receipts include:

- Proceeds from the issuance of bonds or long-term loans
- Sale proceeds from the disposal of fixed assets such as property, plant, or equipment
- Capital contributions from shareholders or owners
- Grants or subsidies received for specific capital projects or investments

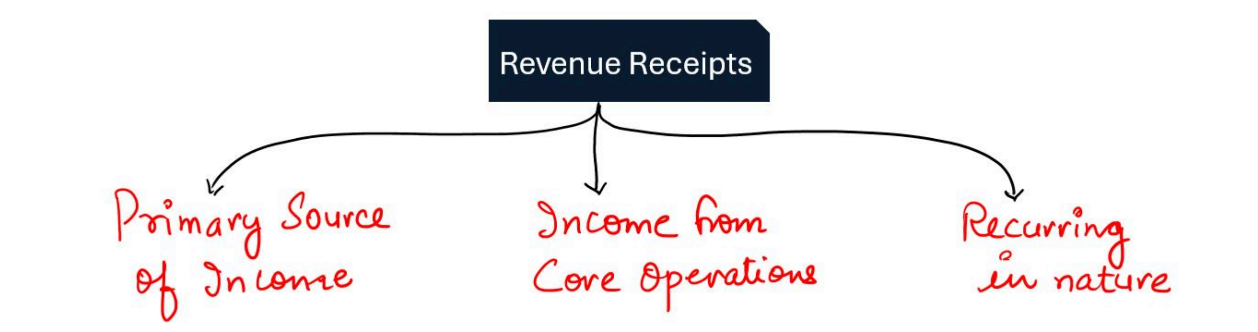
Capital receipts result in either the creation of a liability or the reduction of an asset on the company's balance sheet. For example, when a company issues bonds or obtains a long-term loan, it receives funds that create a liability in the form of debt. Similarly, when the company sells a fixed asset, such as property, plant, or equipment, it receives funds that reduce its asset base.

Capital receipts typically occur infrequently and are not part of the company's regular income-generating activities. These receipts are often associated with one-time transactions or events that have a significant impact on the company's financial position. Examples include proceeds from the sale of investments, receipt of grants or subsidies, or capital injections from shareholders.

Capital receipts have long-term implications for the company's financial structure and obligations. For example, taking on long-term debt through bond issuance increases the company's debt obligations and interest expenses over the life of the bonds. Likewise, selling a fixed asset reduces the company's productive capacity and may impact its ability to generate future revenue.

7. Receipts

Revenue receipts are the funds or income received by a business through its regular and recurring operations. Revenue receipts represent the primary source of income for a business and are generated from its core operations.



Examples of revenue receipts include:

- Sales revenue from the sale of goods or services
- Fees for professional services rendered, such as consulting or legal services
- Rental income from leasing out property or equipment
- Interest income from loans, investments, or savings accounts.

Revenue receipts are recurring in nature, meaning they are received repeatedly and regularly by the business as part of its normal course of operations.

Revenue receipts arise from the core activities of the business, such as sales of goods or services, fees for services rendered, commissions, royalties, rental income, interest income, and dividends from investments.

Revenue receipts are received in the normal and regular course of business operations, reflecting the ongoing transactions and interactions between the business and its customers, clients, suppliers, and other stakeholders.

7. Receipts

The difference between Revenue Receipts and Capital Receipts is given below.

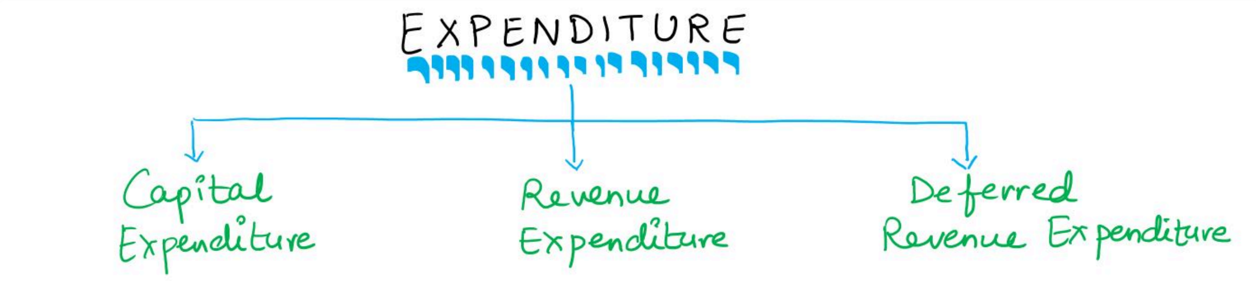
Basis	**Revenue Receipt**	**Capital Receipt**
Meaning	It is a recurring type of receipt; it is incurred regularly.	It is a non-recurring type of receipt.
Purpose	These are available for meeting all day to day expenses.	These are available for meeting long-term expenses.
Example	Sale proceeds of goods, interest received, commission received, rent received, dividend received, etc.	Loan from bank, sale proceeds of fixed assets etc.

8. Expenditure

Expenditure refers to the amount of money spent or liability incurred by an individual, organization, or government for acquiring assets, goods, or services. It represents the outflow of funds from the entity's financial resources in exchange for something of value. Expenditure encompasses a wide range of financial transactions, including purchases, investments, payments, and expenses incurred to support various activities and operations.

Expenditure can be categorized based on the purpose or nature of the transaction. It may involve acquiring tangible assets such as property, plant, equipment, inventory, or intangible assets such as patents, trademarks, or software. Expenditure can also involve purchasing goods for resale or consumption, or obtaining services such as consulting, maintenance, or utilities.

Expenditure may also be classified as follows:



These are discussed next.