

## Corporate Governance: Indian Experience



*The world is going through significant transition in the matter of transparent corporate processes, both on financial front and policy formulation. Transparency in these processes becomes more crucial in case of a public company and from the view point of the credibility of the rights of the external stakeholders. Corporates are for-profit enterprises that are designed to provide sustainable long-term value to all stakeholders. The division and distribution of rights and responsibilities among different participants in the corporates (such as the board of directors, managers, shareholders, creditors, auditors, regulators etc.) and inclusion of the rules and procedures for making decisions in corporate affairs are identified with the help of Corporate Governance mechanism and guidelines. Read on...*

### Role-Players of the Corporate Governance

Before making any discussion on the corporate governance, it is important to refer to a holistic definition to understand its meaning.



\*CA. Amarjit Chopra and  
\*\*CA. Swati Chutani

\*The author is Past President of the ICAI.

\*\*The author is a member of the ICAI. They can be reached at [ajc@icai.org](mailto:ajc@icai.org) or [eboard@icai.in](mailto:eboard@icai.in)

Organisation for Economic Co-Operation and Development (OECD) defines the corporate governance as a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."

Further one has to understand the role-players of the corporate governance, who actively participate in the governance of any entity. They are as follows-

# Corporate Governance

- Board of Directors:** One of the most important role-players of the corporate governance is the board of directors, who have a vital role in selecting a well-qualified chief executive officer (CEO) to lead the company, monitoring and evaluating the CEO's performance, and overseeing the CEO succession planning process. The board delegates to the CEO, and through the CEO to other senior management, the authority and responsibility for operating the company's business. The board also has an obligation towards the auditors to facilitate them with the full disclosures on financial statements of the company. Due to high scale of human intervention in this exercise, it is the most exposed area of corporate governance and independence needs to be established in this specific area. The enactment of the provisions in respect of independent directors is an example of government's effort to fix such exposure.
- Management:** Management led by the CEO, is responsible for setting, managing and executing the strategies of the company, including but not limited to running the operations of the company under the oversight of the board and keeping the board informed of the state and status of the company's operations. Management's responsibilities include strategic planning, risk management and financial reporting etc.
- Shareholders:** Shareholders invest in a corporation by buying its stock and receive economic benefits in return. Shareholders are not involved in the day-to-day management of business operations, but they have the right to elect representatives (directors) and to receive information material to investment and voting decisions. Shareholders should expect corporate boards and managers to act as long-term stewards of their investment in the corporation. They also should expect that the board and management will be responsive to issues and concerns that are of widespread interest to long-term shareholders and affect the company's long-term value. Accordingly, shareholders with majority shareholding influence should not further their personal agendas in the meetings of the boards or the operations of the company, which may put governance at stake.
- Promoters:** A majority of Indian listed entities continue to be promoter driven entities with significant shareholding being held by the promoter/promoter group. Therefore, protection of the interests of minority shareholders, especially those of the retail shareholders assumes greater importance. It is also important to ensure that compensation practices and other factors, especially with respect to promoter directors, do not have undue exercise of the rights and power. Usually in India, promoters take a shelter under the corporate veil in case of default to regulate the governance of the company effectively, particularly when the self-interests of the promoter family take precedence over the interests of other stakeholders. These glitches to an extent have been addressed by the legislature from time to time, by bringing in new rules either through the listing agreements or otherwise but it may be appreciated that there can be no fool-proof law. Rather law breakers find smarter ways to defy the laws. The law makers have sought to reduce the involvement of an individual in various companies by reducing the number of directorship positions that one can hold in various companies. In case of listed entities directorships held

# Corporate Governance

by a single individual will be reduced from 10 to 8 by April 1<sup>st</sup>, 2019 and to 7 by April 1<sup>st</sup>, 2020. Also, any person who is a Managing Director or a whole time director in a listed entity can no longer serve as an independent director in more than 3 listed entities.

Transparency in dealings with in the promoter group companies, in particular, has been a major concern due to complex form and chain of relationships. The same holds true for international corporate entities as well.

- **Regulators:** Regulators are supposed to regulate the corporate entities through laying down of rules and regulations to ensure that the affairs of the corporates are run in transparent, equitable and fair manner to protect the interests of all the stakeholders.
- **Auditors:** Auditors, be it internal or statutory have a crucial role in the corporate governance. Whereas internal auditors play a vital role as a part of management system to, assess the risks internal as well as external, evaluate the strengths and weaknesses of internal control systems, detect any of the errors or frauds at an early stage, the statutory auditors express an opinion on true and fair view of the financial results and the financial position. They render an assurance service to the various stake holders that there is nothing materially misleading in the financial statements. They lend credibility to the financial statements.

All the above role players are the pillars of the corporate governance in a company. Any bad governance at any stage amongst these role-players leads to the failure of the whole system, which ultimately results in loss of money of public at large credibility and sustainability of the company.

## State, Requirement & History of the Corporate Governance

The state of the corporate governance's practice has become so pathetic in the past decade, that it is not at all astounding to see an influential corporate brand name in the list of defaulters of bank or some major financial frauds, ultimately resulting in the loss of the public money. On other note, the degeneration of the corporate governance in highly advanced IT enabled arena and globalisation of financial reporting standard & legislation is also more surprising and matter of worry.

Another angle of the story may be that the reporting mechanism of the instances of the failure of the management or governance has become more efficient. The framework of corporate governance is founded on principles which ensure that the company gets governed in a manner that helps the company to maximise its profits, and expand its operations without compromising on its integrity and uprightness with a full and fair disclosure of the data & information and without affecting the sustainability of the organisation. But in reality the human greed barring in certain groups has forced various pillars of corporate governance compromising in different degrees and consequential failure of corporates and consequentially jeopardising the interests of various stake holders.

Unscrupulous practices of the management for vested interests are well exemplified by one of India's biggest accounting racket, the Satyam Computers Scam, whereby the management and directors possessing direct controls over the activities of the company raised capital from the market at high valuations of their shares by projecting a fallacious image of the company's performance, profitability and financial position.

The increasing trend in the scams and fraud perpetrated by the management due to systems being overridden by the managements to the detriment of various stake holders

# Corporate Governance

particularly the gullible investors is indeed a matter of worry and calls for immediate remedial action.

The failure of corporate entities to realise importance of sound corporate governance structure has led to the genesis of strict governance requirements and has resulted in to stringent preventive laws and regulations both under Companies Act 2013 and SEBI Regulations which is demand of the situation. However, still there are certain measures, though introduced to support the idea of holistic corporate governance, yet these are seemingly not very effective due to failure of on-ground implementation of such measures. Despite such challenges, we as a nation are undergoing a transition in the financial reporting standards and other globally and universally accepted principles to ensure greater transparency. Ind AS introduction is one of such measures though it is faced with challenges with regard to fair valuation issues. Also the banks and insurance companies are faced with different kind of challenges in implementation of Ind AS particularly Ind AS 9. And that is why implementation thereof in two vital financial sector entities stands deferred for the time being.

If we go by the history of the corporate governance practices in India, importance of the same has been realised far greater ever since 1998 may be due to unearthing of Enron scam at international level. Confederation of Indian Industry (CII) introduced India's first code of corporate governance. As it was voluntary at the introduction stage, the adoption was also slow due to disinterest of industry. Thereafter, a committee was appointed under Kumara Mangalam Birla to formulate a code of corporate governance. In 2000, SEBI accepted the recommendations of the Birla Committee and introduced "Clause 49" in the Listing Agreement of Stock Exchanges. Clause 49 outlines requirements vis-a-vis corporate governance in exchange-traded companies,

which became a landmark in the modern corporate governance.

Also, India has shown the resolve to improve corporate governance with a lot of legislative changes in the respective enactments. The legislature has made specific provisions in respective laws which are perceived to be in public interest to facilitate strengthening corporate governance. Few of such changes are given here under:

1. The implementation of the Companies' Act, 2013 and the formulation of NCLT (National company law tribunal) is making more authentic legal base for corporate governance. This will facilitate early disposal of corporate disputes including the matters pertaining to liquidation. We have witnessed liquidation of the companies being pending over 35-40 years even.
2. Implementation of the IND-AS converged from the IFRS for the uniformity of the financial statements in the global horizon.
3. The implementation of the Insolvency & Bankruptcy code also has a quite transparent and law bound disposal mechanism of the insolvency proceedings.
4. The provisions in relation to appointment of independent directors, their role and involvement in the governance have been strengthened.
5. Introduction of rotation of auditors and removal being made more difficult at least during their tenure of five years.
6. Auditors not to be able to undertake management services with a view to strengthen their independence.
7. Automatic cessation from the office of director in case of failure to attend no meeting in a financial year.
8. Compliance with Accounting Standards and Standards on Auditing being made mandatory for managements

# Corporate Governance

and auditors respectively under the Companies.

9. Debarring corporates to make loans to its directors and to such entities wherein they or their relatives have got interest.
10. Making law stringent with regard to related parties transactions (both under the Companies Act and SEBI Regulations) and laying down role of Audit Committee with regard to looking in to arm's length price in respect of such transactions.

## Emergence of the Frauds and Loss of Faith in Corporates

High level of NPAs and stressed assets, including of the agricultural sector, in the banking system of the country (which together may be close to 30 per cent of economy's GDP) has brought in to sharp focus the corporate governance practices in the country. It appears that some pillars of corporate governance failed miserably in discharge of their obligations and caused heavy losses to the banking industry, investors and system as a whole. The practices followed by the bankers may not be above board (and that raises serious issues of governance both in public as well as private sector banks).

If NPAs were cases of mere business failures it would have been an acceptable fact. But financial scams like Nirav Modi, Winsome Diamonds, Satyam Computers, ILFS, Ruchi Soya, Amrapali Builders, Unitech, Gujrat NRE Coke, Essar Group, Reliance Communications, Bhushan Steel, Videocon, etc. are not cases of mere business failures, rather there is lot more in them than what meets the eye. All these culprits including the Board members who have colluded or abetted in frauds need to be held accountable and action taken against them. Case of Mrs Chanda Kochar, a lady who earned every award including Padma, before being penalised due to alleged nexus of transfers of huge sums in her husband's business by Videocon consequent

to sanction of loan by ICICI bank which she headed at that point of time. Case study of Dewan Housing Finance Limited will make an interesting reading as to how a company apparently doing so well suddenly gets in to a mess created by the promoters due to diversion of funds.

As per the 68<sup>th</sup> Report of Lok Sabha Secretariat, published in August 2018, the *“Government has also asked public sector banks to examine all accounts exceeding ₹ 50 crore, if classified as Non-Performing Asset (NPA), from the angle of possible fraud.”*

Following up these scams certain codes, guidelines, methodologies, etc. were institutionalised for governing the conduct of corporate authorities. Schedule IV to the Companies Act, 2013 conveys a *“Code for Independent Directors”* for appropriate corporate governance, *to promote faith and confidence of the investor's community*, etc.

Left uninvestigated for a number of years—a sufficient span to proliferate outstanding liabilities—IL&FS defaulted on a substantial certain loan repayments out of over INR 91000 crore in the first week of September 2018. The reasons for such an occurrence can only be attributed to corporate misgovernance.

The management structure of the corporate giant consisted of a number of non-executive independent directors having a hold on the overall management of the affairs of the company. Some of such directors had long stints on the board, however, despite a number of well-known names on the board, the company took a toll on its debt management system, and other matters of governance.

Given the company's annual reports, IL&FS management consisted of a very vital Risk Management Committee that had several reputed independent directors in it, bizarrely, as per the annual report disclosures; the committee had its last meeting and discussions on risk management in April 2015.

*(...contd on page 120)*

# Corporate Governance

## **Corporate Governance: Indian Experience**

(...contd from page 30)

Moreover, the parent company's standalone profit increased many fold, however, its consolidated performance slumped from a profit of ₹ 800 million to a loss of ₹ 20.9 billion concurrently. Despite such staggering drop in consolidated profits, rather profitability turned in to loss making, disclosed by the company in its annual report, the senior management was not proceeded against by such directors, neither were there any actions taken by the ones responsible for governance.

The IL&FS incident denotes corporate misgovernance and mismanagement of an esteemed listed company, with the world's eminent individuals on its board as supposedly renowned independent directors. The corporate scam illustrates the relevance of an "independent" attitude and unprejudiced and neutral roles of such directors, as even recognized and necessitated the company law.

The code of independent directors as per the relevant Schedule in the Companies Act, 2013 make the key functions of independent directors apparent in areas of strategy, performance, risk management, audit committees etc. The conduct stipulated by the Code stresses on the relevance of exercising responsibilities in a bona fide manner in the interest of the company and various stakeholders. The emergence of scams in the last two decades illustrates the consequence of acting in contrast with these standards.

The annual report disclosures by IL&FS paint a tainted picture of the company, as one can



evidently observe misgovernance, directly or indirectly, on the part of the ones responsible for it. It's a collective error of board particularly the executive directors, shareholders, regulators (as there was no adverse finding by the regulars during their inspections in any of the years), auditors both statutory as well as the internal auditors (as per reports none of these auditors ever reported anything adverse) with regard to working of the company. And interestingly virtually all the bigger firms are involved in the audit of ILFS in one or the other capacity. Even banks have contributed significantly to this episode by apparently ignoring the consolidated financial results. And the losers ultimately are the investors and various other stake holders including the banks themselves.

Needless to say that besides the known pillars of corporate governance, there are certain other agencies having a vital role affecting the quality of corporate governance. These participants are a set of institutions such as financial analysts, credit rating agencies, etc. known as "financial gatekeepers" who help provide investors with timely and accurate information that are necessary to make informed investment decisions. The gatekeepers evaluate the credit worthiness, financial conditions of the firm, and provide independent assurance about the corporations' financial soundness, etc.

However, corporate financial reporting scandals such as talked about herein above have called into question the integrity/efficiency of officials working with such agencies, who overlooked the rising debt levels of these corporations. In August 2018, ICRA relegated IL&FS by just a slight degree from AAA to AA+. Not until it defaulted on a series of loan repayments in September, did the agency drop it down multiple notches.

Scams such as these are spade work of a number of years, involving fraudulent transactions perpetrated by those of reach, access or control. Swindling arrangements have missed the eye of those charged with governance for over a stretch of years, until they emerge from murky depths, long after the scams have flourished.

# Corporate Governance

## A Way Forward to Authenticate the Mechanism of Corporate Governance

1. There is a need to have relook at the appointment process of independent directors and auditors in respect of the listed entities and /or the corporates having public deposit and /or bank borrowings exceeding a specified limit. To provide independence to directors and auditors there appears to be a need to maintain a panel for both the appointments with SEBI/MCA and rather than appointments be made by promoters and managements the appointments be made looking at the experience, qualifications of the persons concerned and matching the same with the size and nature of the companies. The argument is not free from controversy and the supporters of liberalisation may find it difficult to digest. But as the experience of independent directors does not appear to have succeeded, it is high time to put in checks and balances along with liberalisation.
2. India is still an evolving state on prospect of the whistle blowing. To understand the situation of misery, it is to be noted that implementation of "The Whistle Blowers Protection Bill" is still pending to get enacted even after a decade of its ordinance,

which at a macro level is keeping India at a back foot to demonstrate themselves as a proactive nation on the prospect of reporting of fraud and active citizenship. The pre-emptive whistle blowing infrastructure and bye laws will promote people to come out and speak about anything dubious happening around in the corporate.

3. There is a need to have a relook at the mechanism of independent directors. We are not against adequate remuneration to independent directors but the same needs to be delink end to the profits of the corporate entity. It would ensure healthier debates on financial statements of the corporates.

### Conclusive Remarks

On a conclusive note, robust legislature regarding appointment of independent directors and auditors, clear understanding of roles, full disclosure by the auditors, accountability of the board of directors and transparency in the investigative and adjudicating bureaucracy will lead to an ideal corporate governance, which could protect the interest of the various stakeholders, primarily the shareholders, banks and financial institutions, revenue etc.

All these factors are interlinked with each other; any disarrangement in composition may fail the idea of the transparent corporate governance. ■

## ICAI News

### Survey for Seeking Preference for Foreign Language Course from ICAI Members and Students

Committee for Export of CA Services & WTO of ICAI is working on the Action Plan for Champion Sector in which promoting foreign language amongst members and students is one of the mandates by Government of India. With an aim to overcome language barrier and thereby have enhanced professional opportunities overseas, ICAI, through German and Spanish Embassy had initiated batches of German and Spanish Languages for its members and students and is going to start with French, Chinese and Arabic by next quarter.

Interested members/students are requested to kindly express their interest for the preferred foreign language which would facilitate ICAI to open up future batches of foreign languages in their respective jurisdictions. The expression of interest can be provided by visiting [https://www.icai.org/new\\_post.html?post\\_id=15512&c\\_id=240](https://www.icai.org/new_post.html?post_id=15512&c_id=240) which is open till 15<sup>th</sup> May, 2019.

**Chairman**  
**Committee for Export of CA Services & WTO**  
**Email : ceswto@icai.in**