National Conference on Corporate Governance Trends in India

Corporate governance audit: Issues and challenges

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- Corporate Governance through statutes:
  - Corporate Governance is not a new concept.
  - Has been there in one form or another ever since the advent of Joint Stock Companies.
  - Companies Act, 1956 has elaborate provisions dealing with Governance of Companies, especially in Part VI dealing with management and administration of companies.
  - Provisions dealing with Accounts & Audit, Directors, Prevention of Oppression and Mismanagement are noteworthy.

- Governance through listing agreement:
  - Shareholders in listed companies needed additional protection
  - Besides the same, stakeholder protection was also considered important
  - Corporate misfeasance in India and elsewhere necessitated faster reforms in governance
  - Easier and faster way to offer governance protection was through amendment of listing agreement
  - Culminated in introduction of Clause 49 of the listing agreement in 2001.

- Board categorisation under Clause 49:
  - 1. Board of Directors
  - 2. Audit Committee
  - 3. Remuneration of Directors
  - 4. Board Procedure
  - 5. Management
  - 6. Shareholders

Monitoring of Compliance - Issues & Challenges:

1. Quarterly Certificate by Compliance Officer
   - Pre-formatted certificate requiring 'Yes/No' answers.
   - Self-certification
   - Can only give quantitative status not qualitative; of Form not of Substance.
   - Interpretation could be subjective and non-standard especially, when words such as 'material', 'significant', 'substantial' are used.
   - No validation mechanism.

2. Annual certificate by the auditors

- Standard format
- Opinion of the Auditors on status of Corporate Governance conditions under listing agreement.
- Based on representation of the Company concerned
- Again, interpretation could be subjective and non-standard especially, when words such as ‘material’, ‘significant’, ‘substantial’ are used
- No ongoing validation mechanism

3. Report by the Board of Directors

- As part of Annual Report
- Report to discuss compliance of mandatory as well as non-mandatory requirements
- Required to be detailed
- Brings in responsibility of Corporate Governance compliance directly on the Board.

- Consequences of non-compliance:
  - Suspension of listing
  - Section 23 E of SCRA introduced by Securities Law (Amendment) Ordinance, 2004 provides for penalty up to Rs. 25 crores for non-compliance of listing conditions.
  - Loss of reputation with shareholders and stakeholders.

Alternative solutions

- Penalty is not an ultimate solution

1. Monitoring from within required

- Who can play a role from within:
  - Audit committee
  - Independent Directors
- Companies must look at it as a tool for ensuring better valuation- not merely as a regulatory requirement

2. Corporate Governance rating

- A new trend in ensuring corporate governance compliance
- Has the benefit of in depth analysis by experts before rating
- Differential rating for different compliance levels
- Qualitative compliance verification
- Stakeholder interests also protected

- Overall governance conduct of the company rather than quantitative compliance
- Periodic validation for changes in status
- Done by experts in the field with specialised knowledge
- More public faith than self certification
- Expected to increase the company valuation
- Has potential to gain respectability like credit rating.

Thank You