Industry Perspective on Governance

Corporate Governance has been in the limelight in the recent past, particularly with the enactment of the Companies Act, 2013. History shows that whenever there are major scams or stock market crashes, invariably regulations are introduced by Governments across the world to address the causes of the scam. The article attempts to discuss areas that are not mandated by legislation generally but those which enterprises could focus on to help them maintain high corporate governance standards.

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The Securities and Exchange Commission in the US was established in 1934 as a reaction to the stock market crash in 1929. The Sarbanes Oxley Act came about in 2002 as a response to the Enron and WorldCom scams. The Companies Act, 2013, itself was most probably, a reaction to the Satyam and the Sahara scams. Most of the new regulations were made to address the issues that led to the scams. However, while the new laws will possibly help in preventing scams of similar nature, there still remains possibilities of more such occurrences in the future. Recently, the Wirecard scam in Germany seems to almost mirror what happened in the Satyam scam. Secondly, we may still find some people thinking of newer ways to commit fraud. Recent legislation has put the onus on governance, significantly on the CFO and the Company Secretary, besides the Managing Director/CEO as Key management personnel (KMP). It is therefore, in the interest of KMPs, apart from the Board of the Company, to ensure that governance standards are high in the enterprise.

There is also a limit to which law and regulation can address the issue of governance. Corporate governance standards will improve substantially if there is a significant reward to improving them. Companies with high governance standards

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are rewarded substantially with much higher Price Earnings multiples, thereby increasing their market capitalisation substantially. Further banks tend to offer the required funding at more attractive rates because of the lower perceived risk profile. Therefore, it is in the long term interest of enterprises to maintain high levels of corporate governance.

Focus Areas for Enterprises for Maintaining High Standards of Corporate Governance

Corporate Culture

The culture of an organisation starts with the belief of the promoter and top management as to how they wish to conduct themselves. Cultures that do not compromise on integrity, believe in upholding the law of the land in letter and spirit and encourage their employees to speak out without fear when they observe a wrong doing, invariably end up with good governance platforms. Companies following good corporate governance have specific codes of conduct and various policies on issues like ethics, whistleblowing, sexual harassment, insider trading, etc. that are detailed and cascaded frequently to their employees. The important aspect here is that these organisations should actually believe in the codes and policies deeply rather than just put them out to "tick the box" from a governance perspective.

Board of Directors

The independence of the Board is critical to good governance standards. While all Directors have a fiduciary responsibility to the organisation in whose Boards they are, many Boards do tend to get swayed by the views of the promoter's or the principal shareholder's views. Board members, and not just independent Board members, need to realise that their duty is to ensure the benefit of the organisation and not one section of shareholders. The more a Board is truly independent, the better the governance of an organisation will be. It is important that minutes of Board meetings record dissenting views. It is also recommended that meetings of independent Directors are also held periodically so they can discuss issues on governance between themselves. Companies also should have good onboarding programmes for new Directors to help them familiarise with the company and its operations. Another good practice is sending a note on recent regulatory changes to the Board on a quarterly basis.

Board Committees make an important part of the governance structure of a company. The Board Audit Committee (BAC) is one of the most important committees of the Board and has a very big role in driving good governance. While regulations today require the BAC to be manned with at least one financial expert and the others to be financially literate, what is critical is the independence that this committee demonstrates. The BAC has a significant role to play in ensuring that the financials presented give a true and fair view of the company, related party transactions are in the normal course of business and are at arm's length, the control environment is adequate

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for the efficient running of the organisation and frauds and wrong doings that come to their notice are thoroughly investigated. It is a good practice for the BAC and / or the BAC Chairman to meet up with the CFO and the auditors separately before the BAC meeting so there is better understanding of issues and any concerns that the CFO or auditors have can be expressed freely to the BAC.

The Board Nominations and Remuneration Committee (NRC) is an equally important committee that is responsible for hiring and fixing remuneration for the top management. The NRC ensures that there is sufficient oversight on accountability and rewards for management. There is then the Stakeholder committee that oversees relationship and handling of problems with shareholders and in some companies, an Ethics committee as well that deals with issues of integrity and whistleblowing if not handled by the BAC. While the Board is overall responsible for corporate governance of an organisation, the independence and diligence exhibited by these sub-committees are crucial to helping the Board accomplishing the same.

Risk management is another important aspect of governance and Board Risk Management committees can play a significant role in identifying risks of all types (statutory, business, sustainability, environment, competition, obsolescence, etc.) so the company can work on risk mitigation if and when the risks were to occur.

Management

The world is possibly moving from pure shareholder focus to an all stakeholder perspective. Investors are also looking for organisations that are looking long term and have sustainable business models. Organisations that have focused on multiple stakeholder interests and sustainability have actually ended up enhancing shareholder returns substantially. Most of the managements, therefore, are reorienting their focus on all stakeholders. Importantly, belief in the core values and good governance standards for the company is critical for the management team and these beliefs need to be cascaded to all levels of the organisation.

Audit

Statutory and internal audits are mandated by the Companies Act. Here again, it is how companies use these control mechanisms that make a difference to their governance standards. Independence of auditors is paramount. Both statutory and internal auditors should preferably report to the BAC of the company. The BAC should have the final say on appointment and remuneration of both these auditors. While it is practical for the internal auditor to report to the CEO/MD of the company for administration purposes, the reporting line to the BAC on functional matters should not be compromised. There has also been a constant debate on focus areas for internal audit - assurance or advisory. While the degree of focus on the two aspects may depend on the organisation itself, it is important that the focus on assurance is never compromised.

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Internal Financial Controls (IFC)

The Companies Act, 2013, introduced the need for management of companies and its auditors to certify the

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level and efficacy of internal financial controls in place in the company. This followed the regulations as stipulated under the Sarbanes Oxley Act in the US. Onerous as it seemed at the time of initial compliance, the monitoring of IFC has helped organisations in focusing and substantially improving control mechanisms through use of tools like automation, work flows and self-assessment tests, thereby considerably improving governance standards.

Automation and Analytics

Automation has been the buzzword in the last many years and while the aim primarily was towards improving efficiency, the role that it has played in actually improving the control environment tends to be understated. Automation could take out the probability of errors not only by omission but probably also by commission too. Similarly while analytics is used to get more information in improving business objectives, it also plays a very useful tool in detecting frauds and errors if used properly by the Finance team.

Investor relations

Investor relations, is a function that is an important one in the context of listed entities. While the promoter of the company or the majority shareholder typically is aware of the happenings within an organisation and is privy to the strategy, outlook and actual performance of a company, the minority shareholders do not get the same benefit. This is where *investor relations* come in. Stock exchange regulations require financial information or other significant price sensitive information to be disseminated, simultaneously. And while the company may do so because of legislation in place, proactively interacting with investors to keep them posted of key developments in the company including possible impact of recent regulations on business; change in strategy or direction; the company wishes to take; change in top management; effect of competition, etc., is a sign of good governance.

Transparency

This is the hallmark of good corporate governance. Transparency between management and the employees of the company, the management and the Board of Directors, the company and the external world particularly regulatory bodies or investors or media, etc. is an essential part of good governance. Transparency is normally easy and natural when sharing good news to the various stakeholders, but sharing bad news and that too promptly, is what differentiates companies with good governance from those without.

Of late, Auditors (Statutory and internal), Board Audit committees and Chief Financial Officers (CFO) are being charged for direct responsibility in various companies that are being prosecuted for frauds and serious governance issues. It is concerning that in some cases, it appears that the lack of ability to repay debt possibly due to business factors are also being brought under the ambit of wilful defaults and CFOs are being prosecuted for the same. Prosecution in some cases has included freezing of personal assets. Under these circumstances, the need to focus on good governance, ensuring timely and adequate disclosure of price sensitive information and dealing with all stakeholders particularly lenders with full transparency cannot be overstated.

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Concluding Thoughts

Focussing on maintaining high standards of corporate governance in above areas that which are generally not mandated by legislation, are significant for enterprises when it comes to ensuring good governance. ■■■