

Corporate Governance –Beyond Regulations-Way ahead

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August,28, 2020

Concept of Corporate Governance

- Governance –an ingredient in every walk of life.
- Relevance in the Corporate world.
- Need-Due to unique form of corporate business.
- Separation of ownership and control.
- Fiduciary relationship of directors to stakeholders.

CAN GOVERNANCE BE VOLUNTARY

- Can Governance be voluntary?
- Hypothesis about human behaviour.
- Theory X and Y
- Theory-y-Man is indolent, lazy and inherently opposed to discipline.
- Hence need for Regulation-carrot and stick.
- Regulation only means to an end .

Need for Regulation

- Empirical evidence suggests need for regulation to instill governance.
- Force of Regulation Results -Superficial and ticking the box approach.
- Governance is but skin deep , pervasive and dynamic.
- Endless journey without any destination.
- Zenith of Governance-utopian-Relative

Ingredients for Good Governance

- Well balanced, mature and forward looking board.
- Promoter who is well meaning and focused on compliance in letter and spirit.
- Test of Governance-When the going is tough the tough get going.
- Resilience and character of Board shows up.
- Regulation only an enabler to Governance process.
- Substance over form to prevail.

Examples of exemplary voluntary Governance

- Web casting of AGM-two way process in 1993
- Setting up audit Committee 1984 and Share committee in 1969
- Seeking RPT approval prior to 2013 Act.
- RPT approval post Regulations-even when thresholds not breached.
- Withdrawal of candidature of Senior IDs.
- Impost of exemplary damages for trading in minuscule number of shares by director.

Regulation approach-End Result

- Governance by letter of Regulations-Recipe for disaster.
- Satyam Saga
- Jet Airways.
- Murmurs in Indigo.
- The Kingfisher fiasco

Board responsibilities-key areas

- **Responsibilities of Board and KMPs-Reg.4(2)(f)**
- Board's role pivotal
- Disclosure of information-Timely, accurate and fair
- To disclose direct/indirect interest on behalf of third parties transactions/matters affecting company in which there is material interest.
- Need for flexing MBP 1 in light of IndAS-24
- Impeccable Conduct with operational transparency to stakeholders, also protecting confidentiality.
Adherence to fair Trade practices

Key Board Functions

- Review and guide strategy-Scan of Industrial landscape, Competition, Review of annual Budget.
- Review of major capex , Bench marking .
- Decision on Acquisition and Divestment
- Review of Board's Governance and need for reforms
- Succession planning ,develop transparent Nomination process to board-Benchmarking pre-requisites for selection.

Key Board functions

- Ensuring integrity in Accounting and Financial Reporting systems.
- Holding one to one session with Auditors every quarter-Expression of audit concerns and mitigation.
- Audit Committee chairman to hold discussion with Internal audit head-Review-Widening landscape of Audit.
- Review of Whistle blower mechanism

Key Board functions

- Review of risk management policy. Regular meeting of RMC and interaction with Senior Management-Clarity on risk areas.
- Monitoring compliance management. Periodic review of Pending litigation, financial impact
- Probability study and financial impact of pending litigation.
- Review of Evaluation framework of Board

Key Responsibilities

- Guidance on corporate strategy.
- Setting up corporate culture .
- Process of training and keeping board updated on industry trends and policy advocacy.
- One to one interaction with senior management at least once yearly.
- Setting up of Voluntary Committees
- Review of functioning of Committees.

Chairman's role

- Generate positivity and fair play
- Encourage openness and frank interchange of ideas.
- Setting up high ethical and moral standards ,encourage objectiveness and independent judgment.

Related party transactions

- Dichotomy between Act and LODR-as to Related party.
- Formulate policy on RPT and periodic review.
- All related party transactions need Audit approval.
- No concept of Arm's length pricing and ordinary course of business.
- Regulations do not provide for approval of RPT by board . Yet two phased recommendation process recommended .

Monitoring subsidiaries and their performances

- Monitor all subsidiaries whether material or otherwise.
- Appointment of ID on material subsidiary board and reporting by ID on Subsidiary.
- To report to Board on significant material transactions –Threshold 10% of total revenues or Assets of subsidiary.

Reporting timelines to Stock Exchanges-Regulation 29

- Financial Results-Intimation regarding meeting five days in advance .Exclude date of notice and date of meeting.
- Intimation for fund raising-two days notice – Add date of meeting and notice
- Dividend recommendation/ declaration of Interim dividend.
- No Bonus issue without pre-intimation

Reporting on Materiality-Regulation 30

- Transparency and openness hall mark of policy.
- No selective cherry picking of information for dissemination.
- “No low hanging fruits” policy.
- Promptness ,accuracy and timeliness in reporting.
- Application of materiality concept not to be guided by “feel good factor’ alone.
- Report-when in doubt Policy.

Requisites for a good board

- Organizational culture.
- Commitment to Ethics and morality.
- Persons of pre-eminence.
- Good Compensation policy for NEDs and IDs
- Directors' and Officers' insurance policy
- Strong leadership

Tenure of Independent Director

- Section 149(10)-Appointment up to five consecutive years.
- Appointment can be for less than five years equals one term.
- Period prior to present Act not to be considered.
- Concept not in tandem with international practices.
- Views of proxy advisory Agencies contradict law.

Value of Independent directors' Meeting

- **Independent directors' Meeting**
- Very important tool for governance.
- Fraternity to shake off conventional thinking about usefulness of Meeting.
- Entire board should be apprised of outcome of meeting.
- Without feedback, Board will be ill- informed about perception of IDs on Board functioning and on Chairperson's forthrightness.

How Regulations have been strengthened

- Minimum Board Size- 6 Directors .Top 1000 – April,1, 2019 and top 2000-April1, 2020- Reg.17(1)(c) .
- Appointment of NED-Aged 75 and above- approval by Special Resolution-Ordinary business u/s 102(2) Board's role pivotal
- Split in position of chairman and MD .
- Chairman to be NED and unrelated to MD- deadline extend by 2 years

Regulations go stronger

- Alignment of Quorum for Board with Act-Reg 17(2A)-Minimum of three or one third of strength whichever higher .
- Attendance through Video counts
- Annual Remuneration of single NED exceeds 50% of annual remuneration of all other NEDs-Special resolution-Disconnect from Act.
- Reg 26(6)-approval of shareholders and Board for agreements of KMPs and directors for profit sharing-company'

Fetters on Promoter remuneration

- Remuneration of Promoter directors-
- If exceeds 5 Crore or 2.5.% of net profits whichever higher –special resolution
- In case more than one ED from promoter group-Remuneration for them exceeds 5% of net profits-special resolution.
- D and O Insurance for all IDs of top 500 companies –October,1, 2018.
- Reg.25-No alternate for ID

Risk Management Committee

- Committee to be set up by top 500 against 100 before.
- No provision for appointing IDs to Committee.
- Committee to cover cyber security.
- To meet at least once a year . Enough?
- Committee can consist of senior employees
- Applicability of SS1 ?

Policy on RPTs

- Related party transactions
- Policy on RPTs to set out clear thresholds for RPTs.
- Policy on RPTs to be reviewed every three years.
- Payments to related parties for brand usage /royalty not exceeding 5 % of consolidated turnover not to be considered material and exempt from shareholder approval.-July,1, 2019
- RPs can vote against transaction or abstain as before.
- Draft recommendations on RPT policy-Need for implementation.

RPTs AND SECRETARIAL AUDIT

- All RPTs to be reported to Exchange in consolidated form within 30 days of publication of results from half year ending March 31, 2019.-Form AOC 4
- **Secretarial Audit-Regulation 24A**
- To apply to every listed company and material unlisted Subsidiary. Report to be attached to Board's Report.-Dichotomy with Section 204

DISCLOSURES

- Financial statements- More transparent Disclosure
- Providing consolidated results no longer an option
- Q4 results also to be subject to limited review.
- Provision of cash flow statements along with half yearly results-beginning half year ending March 2019
- Limited review of all accounts subject to consolidation.

DISCLOSURES-

- Resignation of Auditor-Detailed reasons to be provided within 24 hours to Exchange.
- Resignation of ID with detailed reasons as provided by ID to be disclosed –ID to corroborate.
- Reporting also in CG Report-ID to confirm .
- Disclosure of following financial ratios in MD&A if there is 25% variation over previous year-
(a)Debtors turnover(b)Inventory turnover(c)
)interest coverage(d)debt equity e)operating/net
profit margin(f)Changes in Return on Net worth
with explanation for variation.

Recommendations that got away-The Kotak Report

- What escaped implementation
- Para 3 –If director does not attend half the meetings held in two years on rolling basis ,continuation in Board-Shareholder ratification
- NEDs to have interaction with senior management once every year- para 8
- Disclosure of details on Board evaluation, action taken, proposed course-Para 13

Omissions from Kotak Report

- Rating agencies to provide reports directly to SEBI
- Certification by PCS as to disqualifications of directors-to be part of Board's report
- MD&A to give perspective on company's medium term and long term strategy.

Kotak Report-Misses

- Payment of minimum sitting fees for directors-with thresholds
- Formal training to IDs once in five years-on role, responsibility
- Regulating information flow as between company and promoters –Agreement to sanctify information share.
- E-voting to end Midnight of AGM
- Monitoring group activity with sub-set of Board. Dedicated group for monitoring group companies/policies

THROUGH THE CRYSTAL GLASS

- Implementation of unfinished Agenda from Kotak Report.
- Ease in holding meetings –Physical meetings to the back burner!
- General Meetings-The virtual type the New Norm.
- Rating of Governance.
- Lesser punishments for technical offences.
- Ushering in of Yogashama.

- THANK YOU