Corporate governance review of the mid-market listed companies in India

2010-11



About the study

We are delighted to release our Corporate Governance Review 2010-11. The review has been designed to analyse corporate governance practices at mid-market listed companies in India.

The report is second in the series of collaboration between Grant Thornton India and FICCI that began in 2008-09. The survey strives to map the movement of industry opinions and interpretation of the established corporate governance mechanism in the Indian scenario.

The review methodology was based on an online and interview-based survey, targeting the top 101-500 companies, as per the Economic Times 500 list, to gauge the nature and extent of corporate governance practices.

The respondents were asked to comment on specific aspects relating to corporate governance practices in their companies and their responses were collated and analysed by Grant Thornton India and FICCI. In addition, views of strong advocates of corporate governance in India were obtained on specific issues emanating from the survey and extracts from the same have been provided in specific sections of the report.

To facilitate an effective analysis of the survey results, the respondents were classified into five tiers, based on their latest available annual revenues, as set out in the table below.

Revenues	%
Less than Rs 100 crore	7
Rs 101 crore to Rs 250 crore	11
Rs 251 crore to Rs 500 crore	4
Rs 501 crore to Rs 1000 crore	25
Above Rs 1000 crore	54

A secondary classification, based on the age profile of the respondents' businesses has also been tabulated below:

Years of existence	%
Less than 5 years	15
5 to 10 years	12
Above 10 years	73

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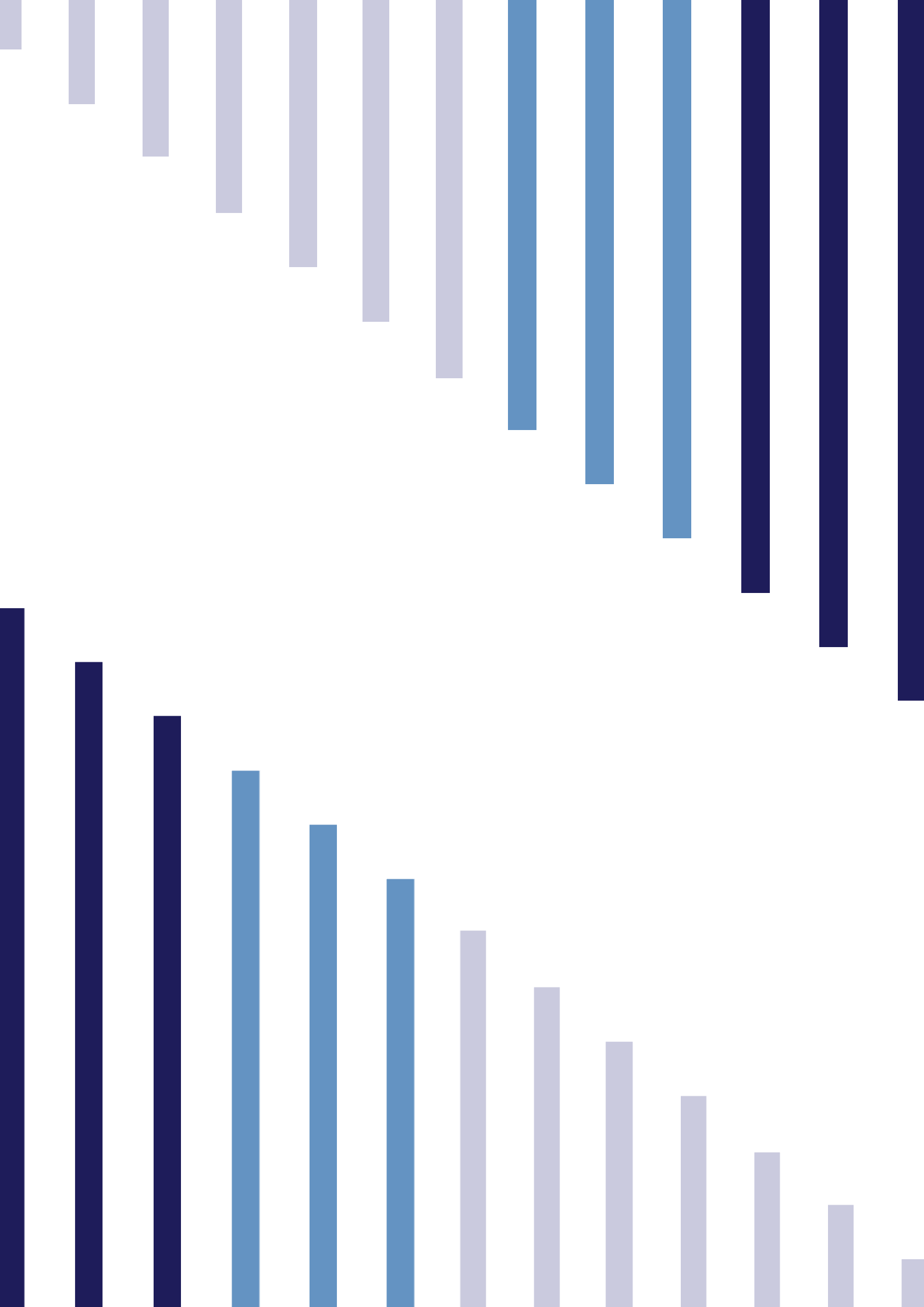
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Foreword

The recent global financial meltdown presented a number of challenges for most economies – at both macro and micro level. As a result, today, we are witnessing a paradigm shift in the market and investor outlook. Investors now look at every financial statement with great care and voice their concerns for a stronger and more independent corporate governance framework.

The instability in the market urged major global players to take quick but cautious steps both at an entity and governmental policy level. Companies needed to respond by enhancing assurance on their activities by adopting more transparent corporate governance practices to rebuild investor confidence.

The drivers for such initiatives were two-dimensional. Firstly, investors demanded more overt disclosure of business developments and strategies that management planned to execute, and, secondly; management teams were on a constant lookout for liquidity in the market facing the credit crunch. A robust corporate governance structure could be catalyst in achieving the desired credibility by ensuring transparency across the business through independent and unbiased review mechanisms facilitated by prescribed norms across various economies, sectors and industries.

Along with the corporate initiatives and the requirements mandated by investors, government policies have brought about an equally strong focus on corporate governance.

The Corporate Governance Voluntary Guidelines 2009, released by the Union Ministry of Corporate Affairs, specify recommendations about the election of independent directors, segregation of duties of CEO and chairperson and related disclosures. The most important part of these suggested measures lies in their universal coverage where companies, even without public money, will have to disclose their corporate governance practices or account for non-adoption.

Historically, like any other set of regulations, applicability and degree of enforcement of corporate governance standards were widely and frequently debated.

Our findings showed that while companies were generally compliant with provisions related with independent directors, publication of results and audit committee etc, there were certain provisions such as internal controls certification and risk management that were adhered to only in form and not in substance.

This report aims to further educate and raise awareness about the level of compliance with the corporate governance norms. We present the prevailing corporate governance landscape in India's mid-market companies. The review includes a perspective of mutual funds, insurance companies and private equity funds. This analysis can also serve as a benchmark for organisations to compare and contrast their own performance with those of others – an important procedure for companies seeking to improve their governance practices.

This exercise was jointly carried out by Grant Thornton India and FICCI. We are confident that this report will provide an insight into the current trends on the subject and a baseline to form an opinion about corporate governance related issues in India.





Dr Rajiv Kumar
Secretary General
FICCI

Vishesh Chandiok
National Managing Partner
Grant Thornton India

Executive summary

During our effort to measure the success of Clause 49 in bringing value to the process of corporate governance with listed Indian mid-sized companies, it was observed that all the respondents who gave a positive response to the existing mechanism acknowledged that they have benefited from Clause 49 in more than one way. However, the degree and type of these benefits varied significantly. 84% of the companies felt that compliance to Clause 49 and the quality of disclosures have improved the investors' perception about them.

Another key positive trend that emerged was that 24% respondents complied even with the non-mandatory provisions of Clause 49. This is a significant indicator of developments to come as compliance to non-mandatory provisions not only helps in better corporate governance but makes adoption of these standards easier as and when they get regulatory back up. One such example is the provision of whistle-blower policy that is proposed to be made mandatory by the new Companies' Bill.

Investor community echoed an equally strong voice in favour of a robust corporate governance system with an overwhelming majority of 90% agreeing to the importance of corporate governance while making an investment decision. As a matter of fact, 78% of the investors said that corporate governance related issues were as important as financial ratios while considering a potential investment. However, 89% of the investors felt that quality of information provided by companies was of reasonably good quality and was relied upon by them in making decisions about their investments.

One of the biggest challenges that looms large on the whole issue of the requirement of robust corporate governance framework is the measurement of the benefits driven from these practices.

This is why, on the issue of creating compliance levels on the basis of size of the company, the industry seemed to be divided where 64% respondents were against it, 27% said it should be done. A number of respondents posited that it can be a cumbersome exercise, in the wake of practical difficulties in implementing such provisions.

The Indian industry is known for the family owned and managed businesses that are tightly held and very closely monitored. Therefore, on the question of separation of ownership from the management, majority of the companies with more than 50% promoter's holdings expressed their dissent to the practice of separating CEO and Chairman's role and felt that the segregation would not yield any significant results. However, on the other hand, companies with lesser promoter holdings felt that it shall be important to separate the two most important offices of an organisation.

Paucity of the required level of knowledge and skills remains one of the biggest challenges for organisations for appointing independent directors. However, the companies responding to the survey seem to be doing little to create the sought after skill-set. 85% of the respondent companies do not have a process for inducting newly appointed directors to their operations. It is because of this "demand-supply gap" that an individual is allowed to serve on the Board of more than one company.

However, most of the respondents believe that technology can help prevent the logistics problem and ensure presence of all the directors who are on the move all the time due to commitments at various boards that they might be a part of. In this regard, 90% of the respondents felt that Board meetings through tele or video conferencing should be allowed by the government.

On the issue of enhancing the independence of Board's conduct to improve the corporate governance practices, only 35% respondents agreed to the suggestion that there should be a lead independent director while 40% opposed any such move. With regard to the maximum tenure for independent directors, 67% companies felt that it should not be defined and that a director should continue to serve on the Board as long as his/ her independence is assured.

However, the new Companies Bill provides for maximum tenure of six years for an independent director and then requires a three-year "cooling off" period before the same person can be reappointed as a director. Another interesting and conflicting fact brought out by the survey revealed that 55% of the companies use the method of "nomination by existing directors" to appoint independent directors. The phenomenon becomes debatable as soon as existing Board members are involved in the selection process. On the other hand, the nomination procedure could be re-characterised as a referral system and keep the process of selection of new members independent of the referral process.

While majority of the respondents (87%) had more than 50% of their audit committee members who were independent, only 21% had a policy of rotating the audit committee members. Another pillar of corporate governance is the independence of the auditor. Survey results indicate that 71% of the companies had appointed their current statutory auditors at least five years back.

As a matter of fact, 50% of the companies are associated with current auditors for more than 15 years. Such long term relationship with auditors could lead to the familiarity threat unless safeguards such as audit partner rotation are put in place.

On the subject of auditor rotation, 36% respondents posited that partner rotation was the solution to address the familiarity threat, 29% felt audit firm rotation could be the solution while an equal number of respondents expressed that neither of these options were appropriate.

However, the idea of appointing joint auditors to achieve complete transparency and reliability on the financial reporting did not attract many advocates as 50% of the respondents opposed the idea of compulsory joint auditor citing difficulties in the integration of two auditors and higher costs as a primary hindrance to the notion.

Risk mitigation turned out to be one of the benefits derived out of good corporate governance practices; 71% respondents agree that outsourcing the internal audit function is a good risk mitigation technique.

Summarising the benefits derived from Clause 49 and the key corporate governance trends in Indian mid-size markets, it is worthwhile to mention that companies feel a sense of security in terms of compliance to the mandatory framework in place. However, much needs to be done to drive corporate governance as an agenda among closely-held work environments companies see no clear benefits flowing from these practices.

I. Clause 49

I. Clause 49

1. Do you feel that companies in India have benefited by complying with Clause 49 of the Listing Agreement?



In order to protect the interests of investors, behaviour of listed companies requires constant and effective vigilance by the regulator. When capital markets systematically open up to both domestic and foreign financial flows, corporate governance requires constructive supervision.

The standards of good governance call for global benchmarking and professional surveillance. Clause 49 is the overarching legal provision in relation to corporate governance. It has provided a framework with respect to rules and composition of a Board and its committees, disclosure of information like the level of activism shown by Directors in the affairs of the company, regulation of the auditors, internal controls and risk management.

Our 2010 survey reveals that all of the respondents believe that they have benefited from complying with Clause 49 of the Listing Agreement. This is in stark contrast with our previous study in 2009 where only 68% of the respondents thought that compliance with Clause 49 benefitted the organisation.

The contrast becomes more interesting in the wake of economic transformation that the Indian economy has undergone during the same period. The economy withstood the meltdown with resilience and adapted swiftly to the global changes via policy efforts that ensured sufficient liquidity with a focus on curbing the inflationary forces. These calculated and cautious efforts led to an upswing in the investor confidence towards the established practices.

Amidst the debates on further liberalisation and the easing out of trade regulations, conservatism turned out to be the saviour. The Indian banking system faced the economic downturn more efficiently than its western counterparts. We believe the conclusions derived from the two years' responses are a good reflection of the change in sentiments pertaining to corporate governance.

As bottom lines return to black and liquidity improves, the corporate governance issues are expected to be considered more prominently in substance as they are seen as key drivers of long term sustainability.

Mr. Deepak Bagla, Partner, 3i Infrastructure Investments while emphasising on the significance of corporate governance indicated that it forms one of the three pillars that facilitates the decision making process for a new investment at 3i.

"Internal controls are important for all sizes of business. However, certain other requirements could be diluted for smaller companies to bring more acceptances to the Corporate Governance provisions."

Vijaya Sampath
General Counsel, Bharti Airtel Group

2. If you have benefited from Clause 49, what is the nature of benefits derived?





Corporate governance framework aims, among other things, to provide credibility to an entity's decisions and initiatives. In other words, corporate governance works as a risk mitigating mechanism by monitoring and certifying management's deeds and helps shield the exposure of various stakeholders who have a direct or indirect interest in the company.

However, in comparison with preceding year, our 2010 survey brings forth a noticeable change in perception on the nature of benefits companies derive from Clause 49.

56% of our survey respondents acknowledged that a robust corporate governance system results in improved procedures and controls. Though, it was explicitly expressed that immunity from inherent risks of an industry is desirable but hard to achieve. Therefore, most of the management teams strive to build inner resistance by placing internal controls and formulating a monitoring system to avoid any deviations.

On the question of whether Clause 49 helps in creating awareness about the roles and responsibilities of management, 56% of respondents said that it certainly does.

Moreover, 56% of the companies surveyed in 2010, against 84% in 2009, see compliance to the current corporate governance standards as a driver of investor perception about the company. However, as compared to 2009, relatively lower population (61%) see these standards as a key factor influencing the valuations.

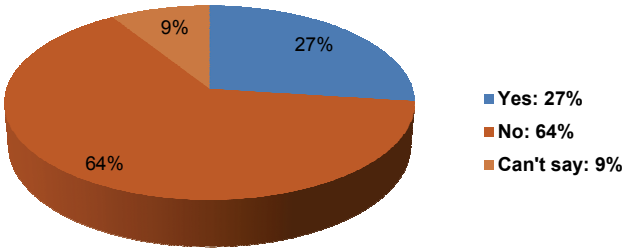
This conflicting observation again brings out the ongoing debate of nature and quantification of benefits flowing from a robust corporate governance mechanism. Though many see it as a factor influencing investor's confidence in the company, very few think that it has any tangible impact on its valuations.

Corporate governance still remains a challenging but invariably important investment for any organisation. The computation of returns on such investments is very complex and subjective without any direct relation with the top line or bottom line of a company.

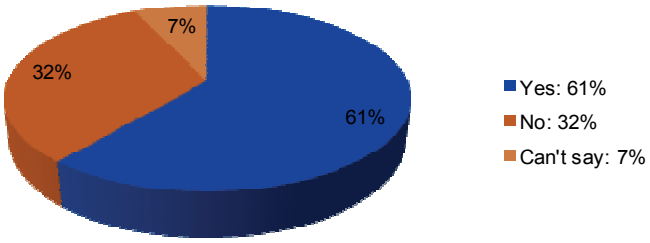
"Unless management sees value, governance cannot be practiced."

M Damodaran
Former Chairman, Securities and Exchange Board of India (SEBI)

3. Do you think SEBI should create different Clause 49 compliance levels on the basis of market capitalisation of the company? (In other words, more stringent norms for companies having larger market capitalisation)



2010



2009

64% of the respondents are not in agreement with the suggestion that SEBI should create different Clause 49 compliance levels on the basis of market capitalisation of the company while 27% of our respondents are in favour of the same. 9% of the respondents chose not to comment.

There has been a significant movement from previous survey where 61% respondents expressed the same opinion about revision in the implementation of Clause 49 as per market capitalisation of companies. This movement is reflective of investor sentiment that remained in jitters and opined that a restructured corporate governance structure could provide with avenues to ensure mechanisms to identify areas of improvements and build better efficiencies in the system. However, as the investment environment has improved, these sentiments seem to be gaining composure and confidence in established framework.

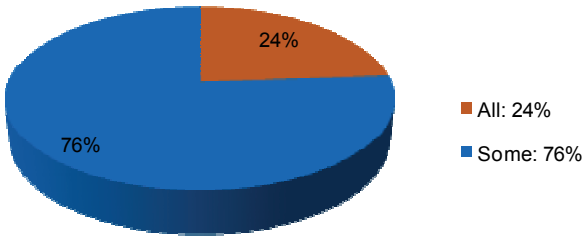
Frequent disagreements have appeared against the "one size fits all" approach of our regulators in terms of enforcing Clause 49 regulations to all the listed companies irrespective of their size and industry. Some of the responses received through our direct interaction with various interest groups revealed that corporate governance should be aligned with the nature of business and industry in which a company is operating. However, this seems to be impractical to implement due to diversity and ever expanding scope of the businesses. That is why there are not many supporters of this idea amongst regulatory circles.

At the moment, Clause 49 establishes, describes and monitors corporate governance of all the listed companies. Even though the universal approach of the Clause has been frequently criticised, the survey results tell us that Indian entrepreneur is reasonably satisfied by the current system in place.

"Market capitalisation could not be the only criterion. There could be other parameters for differentiation like public holding as a percentage."

Chitra Ramakrishna
Joint Managing Director, National Stock Exchange (NSE)

4. Do you comply with the non-mandatory provisions of Clause 49?



76% of the survey respondents posited that their organisations follow some of the non-mandatory provisions of Clause 49 while 24% of the respondents have adopted the non-mandatory suggestions on whistle-blowing and independent directors as part of their corporate governance framework.

Beyond the mandatory guidelines, Clause 49 also prescribes additional steps that could further help organisations drive their corporate governance more efficiently. Two primary areas covered under these prescriptive norms include the whistle-blower policy and suggestions on tenure of independent directors. The objective of these recommendations is to fill the gaps in the current system and complete the spectrum of risks that corporate governance is expected to cover. Non-mandatory provisions also play a role in acclimatising the industry so that eventually these can be made mandatory.

Non-compliance to the non-mandatory requirements reinforces the view of the Indian corporates on what is the 'material' benefit derived from Clause 49. However, it needs to be highlighted here that these provisions are 'mandatory' in nature in some of the more matured Western markets.

Currently there are two areas that are prescriptive in nature to strengthen the corporate governance structure of an organisation. These include:

- **Whistle-blower policy:** The matter involves the confidential and uninterrupted communication of any unethical/ illegal activities in an environment to the audit committee.

- **Restriction of the term of independent directors:** Clause 49 suggests that in case of an independent director, the tenure on the Board should not exceed more than nine years, comprising three tenures of three years each. If an independent director continues to serve on the Board of a company for a longer term than the prescribed limit, he/ she should no longer be treated as independent.

"Good governance doesn't guarantee success, but the lack of it is very often the cause of failure. The long term sustainability of a business rests on the pillars of transparency and fairness, and those with long-term vision for their organisations acknowledge that corporate governance is more about inclusive and thus sustainable growth than enforcement."

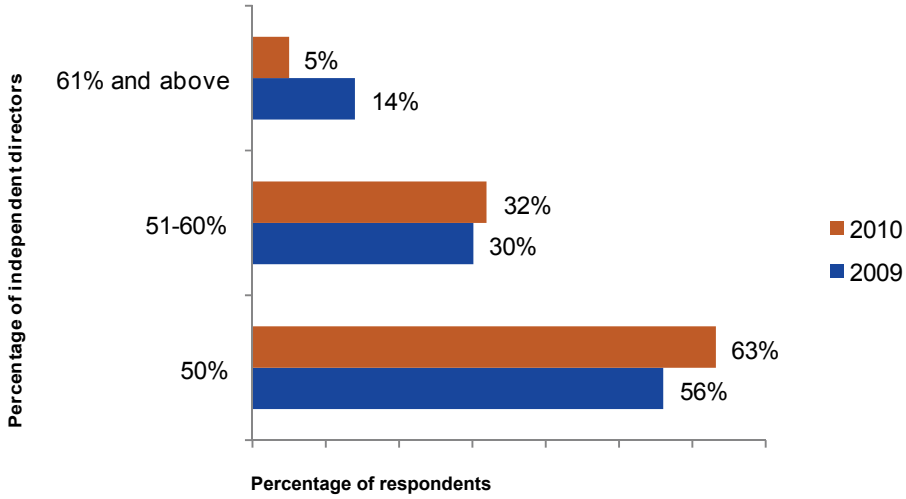
Lav Goyal
Partner and Practice Leader – Business Risk Services
Grant Thornton India



II. Board of directors

II. Board of directors

5. What according to you constitutes an ideal Board structure? How many Independent Directors should be present on the Board?



Independence at the Board, committees and executive positions helps in providing unbiased and insightful leadership. Companies should really strive not only to meet the Clause 49 recommendations, but also to implement measures to eliminate or mitigate other risks that could adversely impact the value of shareholders' stake into the company.

This calls for an adequate knowledge pool that could protect and enhance the value creation in an entity. This fundamental requirement lies at the base of argument pertaining to ideal size of a Board. However, there is no universal agreement on the issue.

Certain quarters of the industry feel that to have 50% of the Board as independent Board is too stringent requirement (if the chairman is not independent).

It has also been expressed that since executive directors are critical to the functioning of the company, it's important to have them on the Board. **As per present norms, for every executive director on the Board, an independent director needs to be appointed.** This school of thought further advocates that this would increase the Board size unnecessarily.

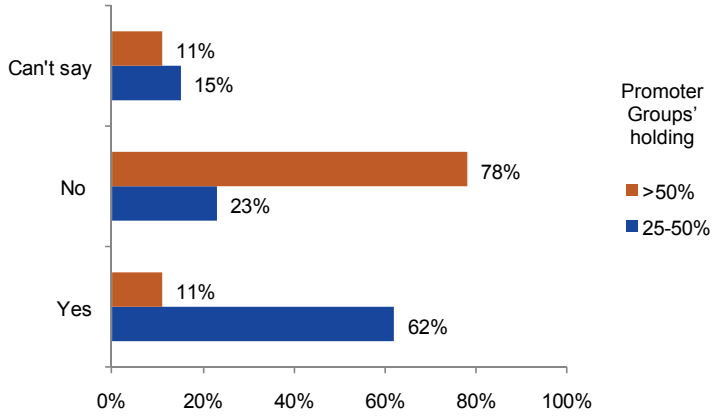
However, the argument loses ground on the basis that an independent review system is indispensable for any organisation. However, given the demand-supply gap, it is advisable that at least one-third of the Board should be independent irrespective of the chairman being executive or non-executive.

Independence of directors weighs heavily among the investing community. Indian companies fare reasonably well on the issue of independence as 67% respondents feel that the directors of the companies they had invested in were 'independent' enough. Remaining 33% had reservations on the issue and thought that directors were not adequately 'independent' in the companies that they were involved with.

63% of responding companies believe that approximately 50% members on an ideal Board structure should be independent. Almost 32% thought that a formation of 51-60% independent directors is ideal to ensure a robust corporate governance structure.

This same trend was observed during the last survey results where 56% of the respondents thought that 50% independent directors would be an ideal formation.

6. Do you think separation of CEO and chairman's office would lead to better corporate governance and operational performance?



Our analysis of the responses from promoter-driven and non-promoter driven companies substantiated some historical trends of closely-held management teams being more conservative to the segregation of offices of CEO and the chairperson.

With the companies where promoters own greater than 50%, 78% were of the opinion that the segregation of the two most important offices would not yield any significant benefits. In the case of 25-50% promoter holdings, 62% thought that it would be important to segregate these two offices.

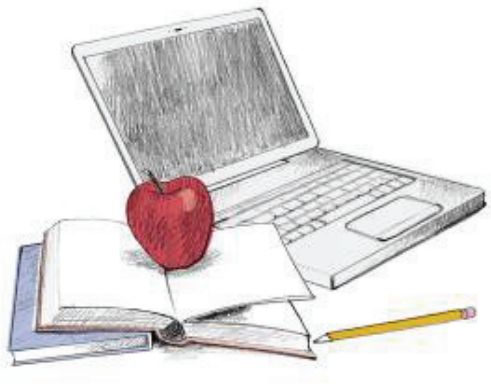
The argument again finds its origin in the capital structure of the organisations. Clearly, there is lesser acceptance of professional management in the promoter driven companies. However, on analysing the complete sample population, we see that a majority (58%) has identified that the issue of separation of these offices is required to cement the monitoring mechanism of an organisation.

Many advocates of improved corporate governance assert that the offices of CEO and chairperson should not be held by the same individual, which in turn could ensure better transparency. In addition, this segregation of roles would result in a more professional management of the business.

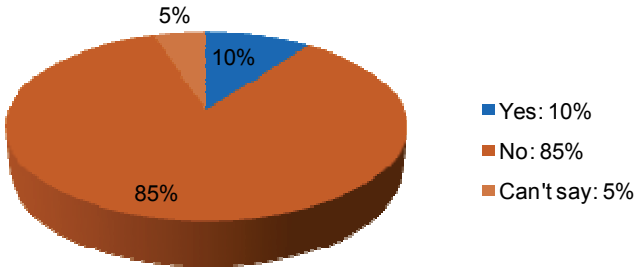
Balance of power provides companies with the ability to manage themselves more effectively.

"Separation of CEO and Chairman's office is not sufficient if the inherent culture of the organisation is to work as a family and not as a professional set-up. If it is family, even if there is segregation, both positions will work together."

Mr. Udayan Bose
Chairman, KC Corporate Financial Advisors Pvt Ltd



7 Is there a process in place to ensure that newly appointed directors undergo a structured induction programme on joining the Board?



A whopping 85% of the respondents admitted to inadequate procedures to help newly appointed directors become acclimatised with the organisational environment. Generally, it is assumed that a person appointed on the Board will have sufficient knowledge/ experience in the complexities of the relevant business and industry. However, in certain scenarios, especially in case of independent directors, an induction into the operations and culture of a company may help an individual start contributing to the Board right from the outset.

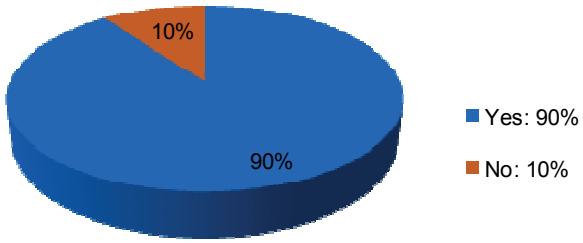
It is imperative for an organisation to ensure that all the members of the governing body are familiar with the functionalities and other aspects attributable to the business.

This will help an organisation in maintaining harmony in its operations and further building efficiencies to benefit the business.

Directors of companies carry a considerable responsibility and liability and hence it is important that every director, new or longstanding, has a clear picture of his or her responsibilities.

A director needs to aware of a company's ongoing commitments and liabilities. Once an agreement is reached to join the Board the new director needs to be inducted into the Board's processes and procedures so that, from the outset, he/ she can make a sound contribution.

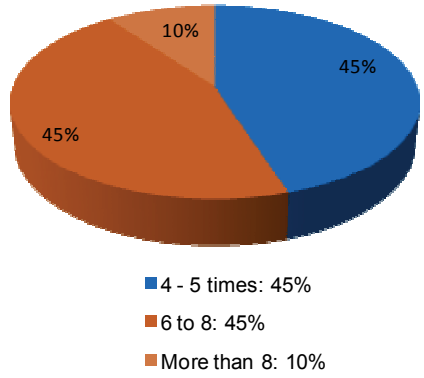
7.1 Are they appraised regularly on emerging issues and industry trends?



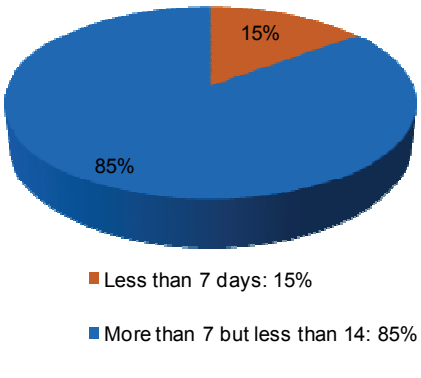
The process becomes more important in case of non-executive directors.
The contrasting school of thought puts time constraints as a hampering agent to the knowledge transfer. However, this is countered by the argument of limiting the number of directorships that a person can hold at one point of time.

The survey respondents agree with the fact that the Board in their organisations are regularly appraised on emerging issues and prevailing industry trends.

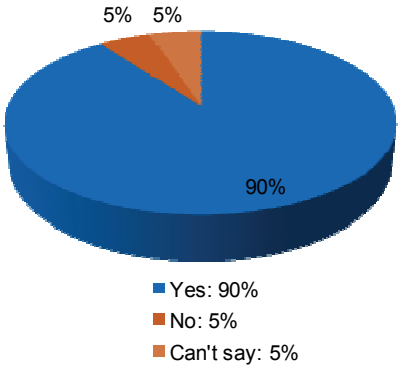
8. How frequently does the Board of directors meet in a year?



8.1 How much in advance do you circulate the agenda papers for the Board meeting?



8.2 Do you think that attending Board meetings through tele or video conferencing should be allowed?



Clause 49 directs all Boards to meet at least four times in a year to review the performance of their organisations, with minutes of the meetings made available to all the shareholders.

As a standard practice, most of the Board meetings are held on a quarterly basis when companies are in the process of releasing their quarterly financial results. However, the Clause does not set the upper cap on the number of Board meetings.

As compared to last year, where most of the respondents complied with the minimum regulatory requirement of at least four meetings in one financial year at a gap of not more than four months; we can see a slow but clear movement towards the increased frequency of Board meetings A greater number and frequency of Board meetings could also be due to adverse market sentiments during last year. As global exchanges are showing no clear direction for the near future, management teams across the globe are more vigilant than ever before.

Despite expressing reluctance towards adoption of new guidelines and other amendments, the management teams across the globe have been very open to adapting new technologies that facilitate faster communication and more efficient decision making.

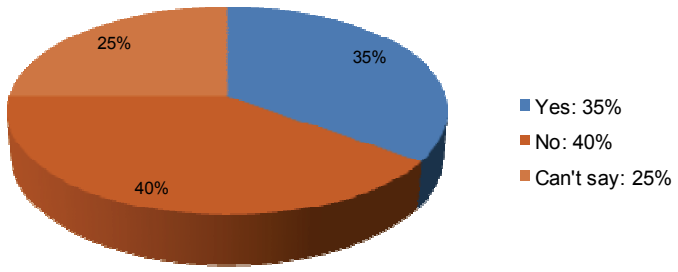
Using technology, organisations can ensure seamless connectivity amongst people across the globe efficiently. It is equally important that the companies are allowed to have Board meetings through electronic means rather than only by physical presence, as is being proposed under the new Companies Bill.

The number of days in advance that a company sends the agenda for Board meeting ranged from one to two weeks where 96% of the respondents circulated the agenda between 7-14 days as per the regulatory requirements.

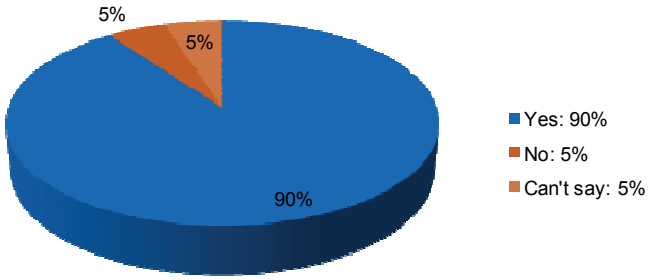
III. Independent directors

III. Independent directors

9. Do you think one should have a lead independent director who acts as a spokesperson for the independent directors and drives a consensus among independent directors on various issues?



9.1 Based on your experience, are you satisfied with the outline of the current roles and responsibilities of members of the board of directors of your company?



Independent directors have been one of the most contentious subjects related with corporate governance. Whereas there seems to be a wide consent about their importance in an organisation, there is a thick cloud of issues surrounding the subject. **An array of debates encompass the procedures and policies pertaining to the appointment of independent directors, their degree of 'independence' from the rest of the management, and integration of their knowledge with the company and vice versa.**

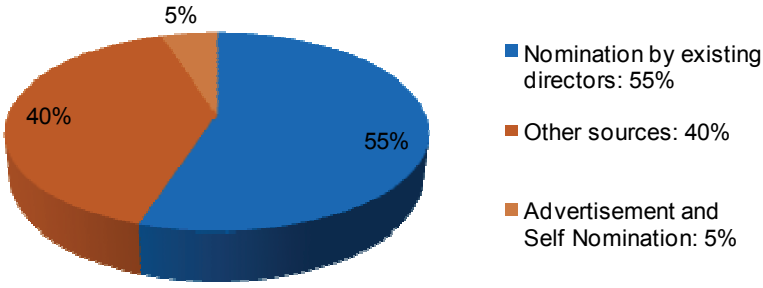
Only 35% of the respondents feel that a spokesperson from the independent directors should communicate and express the opinions of independent directors as a whole. A large number of respondents (25%) decided not to comment. A few of the largest companies in India have a practice whereby a meeting of independent directors is held before the Board meeting so that they can discuss the agenda items.

However, the degree of independence and roles often blurs with the passage of time. This happens due to over-familiarisation with the organisation that an independent director is associated with. It also forms the convergence point of argument for the tenure of the independent directors. Clause 49 suggests that an independent director should not be regarded as 'independent' after serving three consecutive terms of three years each.

However, application of the same cannot be stringently implemented as different business environments demand different approach. The same argument finds a haven in the analysis of the responses where 67% companies feel that the maximum tenure of the independent directors should not be defined.

90% of the respondents were satisfied with the defined roles and responsibilities of their respective independent directors and thought that they were sufficient to achieve the desired results.

10. How do you select your independent directors?

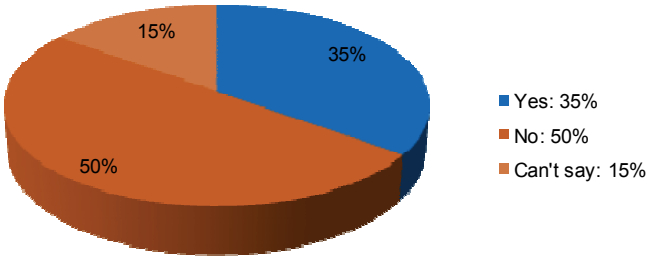


One of the arguments revolving around the issue of the 'independence' of the independent directors involves the process of their appointment.

Our survey revealed that, most commonly, independent directors were nominated by existing directors. This process itself is questionable as it is very likely that the directors, with a considerable direct interest in the company, will select a person who is better aligned to their motives and is not independent as per the requirement in Clause 49.

However, most of the companies argue that there is a considerable dearth of qualified independent directors.

10.1 Do you think that the criterion for the independence of the directors should be materiality with respect to director's financial position rather than the company's financial position?



To overcome this limitation, some of the larger companies have not limited themselves only to Indian citizens. Another argument that is worth considering in the case of appointment of an independent director is the 'materiality' of the pecuniary relationship between the company and independent directors.

The central issue is to keep the independence of directors intact by ensuring that the integrity of independent directors is not compromised due to financial considerations.

The argument of considering the candidate's financial position has not gained ground as the assumption is that these individuals might not be comfortable in disclosing details about their personal wealth.

This hesitation is also reflected in the received responses where 50% rejected the argument considering it unfeasible. However, a minority of 35% considered it worth a try and 15% chose not to respond.

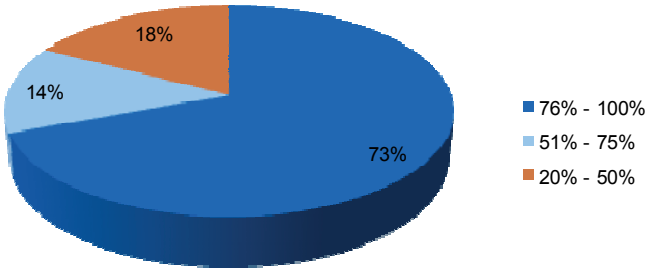
"Unless we see financial activism, we cannot see individual activism."

M. Damodaran
Former Chairman, SEBI

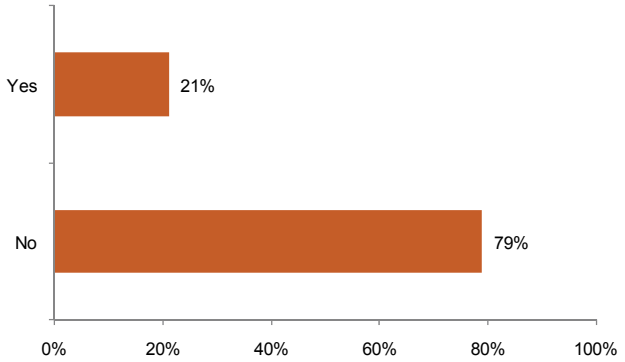
IV. Audit committee

IV. Audit committee

11. What proportion of the audit committee comprises independent non-executive directors?



11.1 Does the company have a policy for rotation of audit committee members?



An audit committee lies at the centre of the financial prudence and risk management framework of an organisation. An audit committee is responsible to ensure that the correct financial reporting standards are followed to account for all the financial transactions.

Considering the sensitivity of the responsibilities endowed upon the audit committee, it is very important for its members to be independent to facilitate fair and complete disclosure of all the material events to shareholders.

The increasing importance of the role of the non-executive director in implementing good governance in practice is all too evident in recent corporate failures and frauds. There is a growing realisation among chairman, chief executives and nomination committee members that, with the exception of the not-for-profit sector, it is neither the title nor name alone, rather the individual's ability to introduce robust, informed challenge – or as one chief executive put it: "constructive tension" – that truly adds value to the Board.

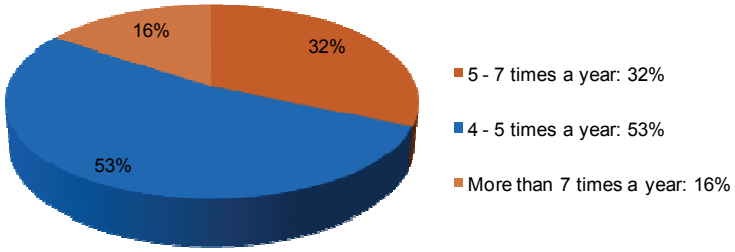
In our survey, the responding companies seem to be addressing the issue of independence of the audit committee fairly well. Almost 81% of the participants had an audit committee with independent non-executive directors forming more than half of the committee.

It may be noted that Clause 49 requires that at least two-third of the audit committee should comprise of independent directors. Our survey reveals that there are companies that are not complying with this mandatory requirement.

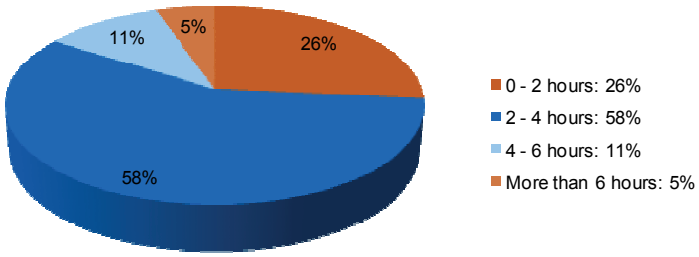
A considerable amount of time has been spent discussing the issue of rotation of statutory auditors. However, not many opinions have been shared about the issue of rotation of the audit committee. The argument again originates from the cause of ensuring sufficient internal controls and transparent financials to upkeep investor confidence and market credibility. A periodic rotation of the members would not only enable a more independent control on the company operations, it can also be a tool to bring in fresh perspectives on the reporting practices used by an organisation.

However, like independent directors, the demand-supply gap is quite large and there is an acute dearth of manpower to constitute fresh audit committees on a regular basis. It is this lack of knowledge pool that made 79% of the respondents respond against the idea of rotation of audit committee.

12. How frequently do the audit committee members meet in a year?



12.1 What is the average duration of these meetings?



Audit committees have been directed to meet at least four times in one financial year with a gap of not more than four months between the two meetings. As a result, most of the audit committee meetings, like Board meetings, are conducted before the publication of the quarterly financial reports.

Our survey revealed that though all the companies are compliant to Clause 49, only a few go beyond the prescribed level. 53% of the responses stated that their respective audit committees met between 4-5 times in a year. Only 16% met seven times or more.

The audit committee should be meeting more frequently as it is the approver of all the financials disclosed by the company, before formally making them the part of the company books that are presented to the shareholders.

Therefore, it is widely and strongly suggested that an audit committee should be better integrated with the management and should review its operations and corresponding reporting mechanisms. The director has to be aware of the business and its complexities in order to be able to review the management's work and give his feedback than be in a deciding capacity.

Another aspect of audit committee activity that is worth discussion in conjunction with the frequency of their meetings is the amount of time spent on these meetings to discuss the critical financial/ operational matters in a business environment.

Our survey reveals that this period currently ranges between 2-4 hours. However, whether this is sufficient or not, depends on several factors.

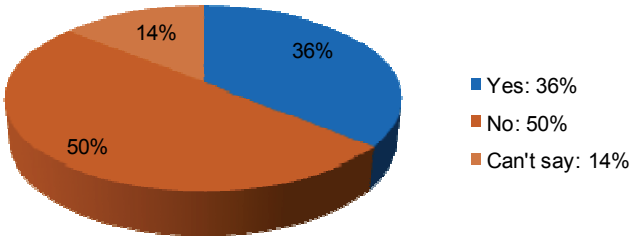
Although we clearly observe a movement towards longer meetings as compared to the last survey, the effectiveness of the same is still not at the desirable level. Most often, time constraints are put forward as the strongest argument against longer meetings. However, technology could provide solutions to such issues.

Almost 90% of the companies responded positively when asked if the work of the audit committee was given sufficient coverage in their annual reports and that they had implemented a structured framework for assessing the internal controls over financial reporting.

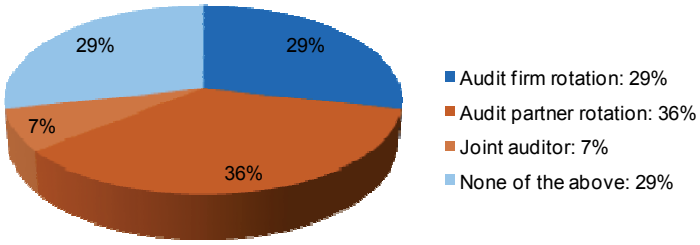
V. Auditors

V. Auditors

13. Do you think compulsory joint auditor of all companies shall bring in more transparency?



13.1 How can the auditors be made more independent?



Discussions on making joint audits mandatory have recently gathered momentum. The idea is to appoint two or more auditors to audit different areas of a company's financial statements and express joint opinions on the financial statements as a whole. Our survey reveals that majority (50%) of the respondents have felt that joint statutory auditors may not be the solution to provide the required and desired level of transparency. However, 36% feel otherwise and 14% chose not to respond.

Transparency, objectivity and authenticity of information shared with the shareholders are the key areas that corporate governance standards intend to address in any environment. The ultimate chain of communication and the correctness and cohesiveness of disclosed financial information is certified by the auditors.

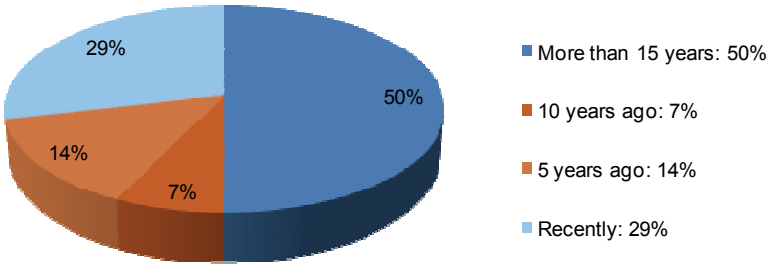
Auditors have a responsibility to report any material misstatements in the financial statements. In order to facilitate an unbiased analysis of the company's books, it is very important that auditors are independent to carry out their analyses. However, the viewpoints on the issue remain diverse as none of the frequently proposed systems seem to be an ideal solution for these issues. Our review reveals mixed trends with 36% favouring the system of rotation of the engagement partner whereas 29% considering audit firm rotation as a solution.

"Mandatory rotation of audit firms may entail several unintended negative consequences, when compared with illusions of gains. It is noteworthy that international experience is against rotation of firms, and in many cases it was tried and abandoned. There are other alternative, yet more effective measures, of governance to ensure auditor independence, and rotation can be mandated through rotation of partners/teams." – FICCI

During our survey, respondents expressed their opinions on the qualitative aspects and arguments for and against joint auditors. It has been perceived that joint audits can increase cost to the company, lead to inefficiencies and do not necessarily increase audit quality. Also, there are possibilities of omissions during the audit with one firm blaming the other for mistakes and the danger of an "unlevel playing field" vis-à-vis international counterpart.

Of the G20 countries, only France has a tradition of joint auditors. Denmark did have joint auditing, but the mandatory requirement was abandoned in 2005. The choice should rather be left to Audit Committees and shareholders to weigh the advantages and disadvantages of a dual appointment and not be mandated.

14. When did your company rotate your auditors last time?



Rotation of auditors is one of the most debated matters currently. Supporters stand for frequent rotation of auditors to ensure an unbiased and fair opinion on corporate affairs.

The International Federation of Accountants (IFAC) Code of Ethics mandates the rotation of the audit partner at least every 7 years to protect against over-familiarity. However, the mandatory rotation of the audit firm has been tried in some jurisdictions and has had a very chequered history.

Out of all the G20 economies, only Italy has mandatory firm rotation on a continuing basis. It has been abandoned in Spain and Brazil and also Korea, after having adopted it for most public companies.

A number of arguments revolve around the subject of rotation of auditors. For instance, it is said that this practice may erase the cumulative knowledge of an audit firm and thus reduces audit effectiveness. Moreover, it is also perceived as a market-distorting mechanism, creating significant practical difficulties.

These notions were corroborated during our survey wherein 50% of the respondents have had the same auditor for more than 15 years and a small percentage (29%) had recently switched to a new audit service provider.

In a concurrent survey with the investor community, 67% of the investors supported the idea of a more frequent rotation of the auditors and prefers to appoint new statutory auditors as soon as stake in a company is acquired.

On further enquiring about the extent that an investing entity enforces on a company to ensure transparency and probably a professional management, surprisingly mixed and balanced opinions were brought out where 33% of the respondents said that they recommended a new appointment for the position of CFO, 33% were against and 33% were undecided on the issue.

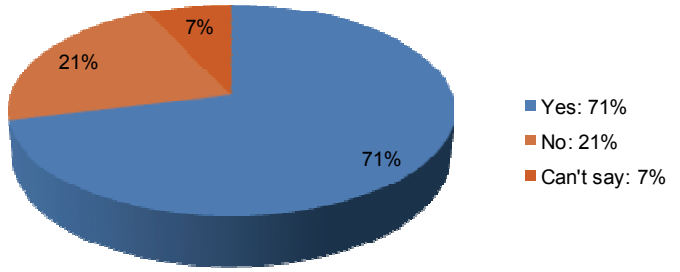
"Auditor's familiarity with the business is a must. However, there is a thin line between familiarity with the business and familiarity with the management."

M. Damodaran
Former Chairman, SEBI

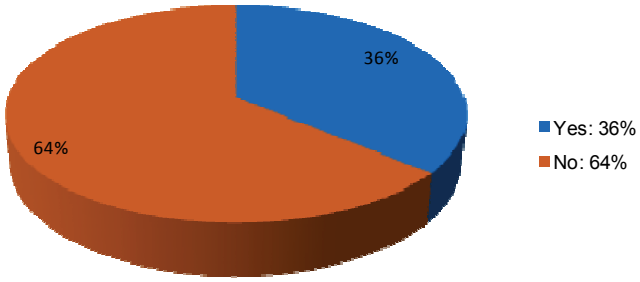
VI. Internal controls and risk management

VI. Internal controls and risk management

15. Do you think that outsourcing the internal audit function will ensure better independent review of operations and add value to the internal audit process?



15.1 Does your company have a Chief Risk Officer (CRO)?



Internal auditors work as a firewall to the operations of a company, and are expected to review the company procedures and disclose all the exceptions that are a result of non-compliance to the implemented procedures or a consequence of the lack of controls in the established systems.

As a process, internal audit claimed significance in the post-Enron era. Nowadays, most large organisations have separate departments, which oversee the internal audit function. However, many organisations also believe that internal auditors, like statutory auditors, should be independent of any influence that can possibly be imparted from within the organisation. This conclusion gets substantiated in the answer to this matter raised during this survey.

A large population, 71%, agreed that outsourcing of internal audit function would yield better results, add more value to the current processes and mitigate the existing risks to a great extent. Internal auditors' review is also a part of the investor confidence building mechanism. All the investors, responding to our survey, placed a certain degree of importance over the assessment of company operations carried out during their reviews.

On further enquiry of internal risk control mechanisms, we found out that only 36% of the responding entities had a person appointed as CRO. The rest of the respondents had no such position in place. While sharing his insights, one of the ex-regulators felt that compulsory outsourcing of internal audit is a must and should be widely implemented and practiced.

"The effective functioning of internal audit as a process is more important whether done internally or outsourced, and the effectiveness of internal audit as a function will largely depend on the tone at the top which will include initiatives on corporate governance like setting up audit committee, taking adequate reporting, addressing key issues etc."

Chitra Ramakrishna
Joint Managing Director, National Stock Exchange (NSE)

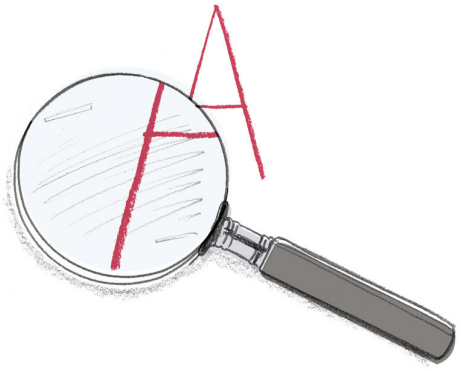
16. What are your suggestions to improve the state of corporate governance in India? What could be a possible audit or check mechanism that can be implemented by SEBI to ensure compliance with Clause 49 requirements?

The survey brought out several suggestions for improving the state of corporate governance in the country. Although all the participants did register their concerns and recommendations, the scope and nature of suggestions varied significantly.

Some respondents suggested stricter financial implications in the case of non-compliance, whereas, some emphasised that the current guidelines be implemented in spirit and substance than letter and form. Additionally, it was found that management teams across various sectors expect some kind of recognition on pursuing corporate governance guidelines.

Apart from these responses, opinions about independence and better integration of auditors with the management were also echoed very frequently during our interactions.

However, to reflect all these changes in implementation and in spirit of the organisations, more valiant and voluntary steps would be required from corporates across the country.



SEBI is the government's watchdog to ensure compliance with all the mandatory regulations of Clause 49. On our queries about the role that SEBI has played in developing corporate governance norms so far and how it could be improved; most of the respondents were convinced that it has played a major role in implementing Clause 49 in its current state today.

However, all the respondents almost unanimously voiced their concerns about a more active role to be played by SEBI in improving the current compliance levels. The most common suggestion that came to the fore was that SEBI should conduct independent corporate governance compliance audits, in order to understand the practicalities and other externalities attached with the adoption of these standards. Some of the respondents also suggested for a periodic and independent third-party review of corporate governance norms both at the policy and implementation levels. Such practices would also ensure that the companies are more vigilant in pursuing these guidelines.

Acknowledgement

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Chitra Ramakrishna
M. Damodaran
Udayan Bose
Vijaya Sampath



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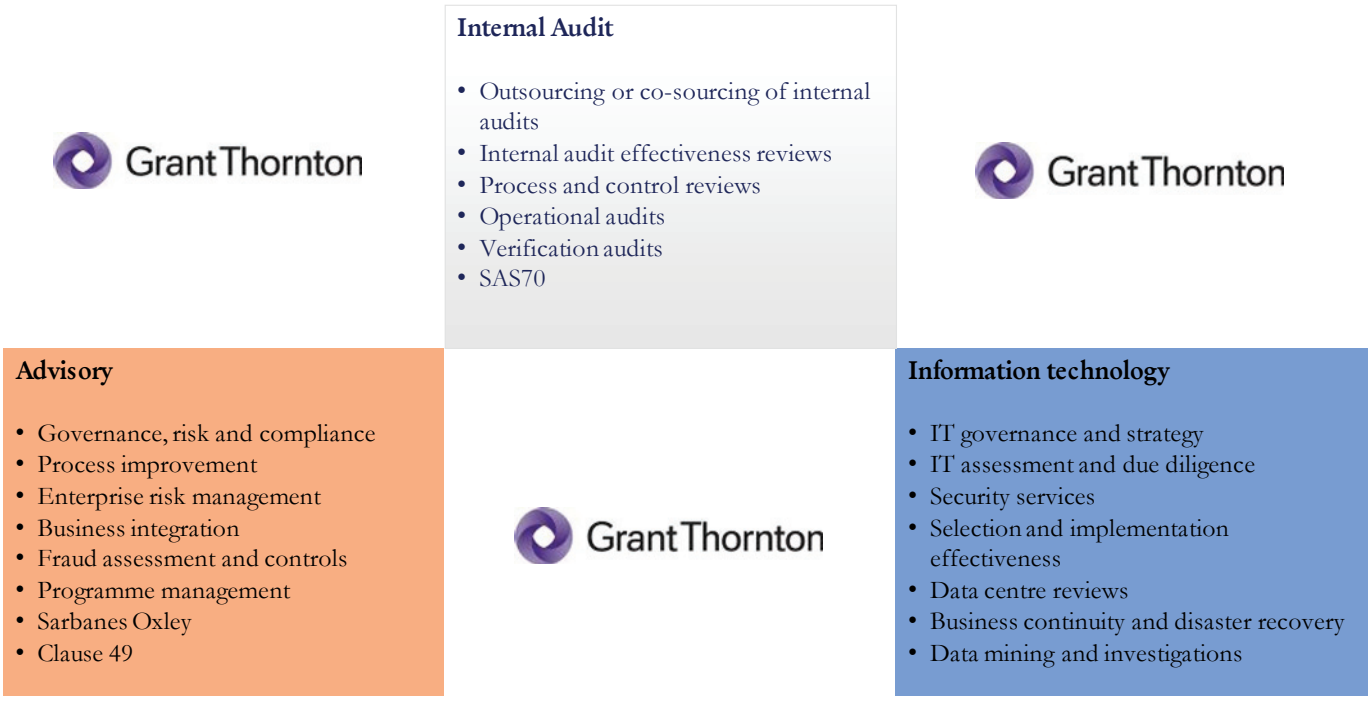
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