With increasingly negative reports regarding the state of Corporate Governance in India, Independent Directors are experiencing a feeling of inadequacy and, perhaps, irrelevance in boardrooms. Not being able to grapple with financial statements is a major cause of concern. There is no finite list of matters that Independent Directors should look out for to ensure that a company is on the right track. Some of the more obvious matters that cry out for attention are highlighted in this newsletter.

Editor

Aspects of ACCOUNTability

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The role of Directors, especially Independent Directors (IDs), has come up for close scrutiny and significant adverse comment, in the light of governance failures, in an increasing number of companies. It is both easy, and entertaining, to conclude that these Board-level functionaries, brought in not only for their experience, but also for their commitment, were sleeping on the job while things were going wrong around them. The more plausible explanation, which surfaces in private conversations, is the feeling of inadequacy that even well intentioned Directors experience in the face of increasing demands on their time and their competence. This sense of inadequacy is especially heightened when it comes to decoding financial statements and recognising early warning signals. While the signals that one should look out for are many and varied, it is useful to focus, as has been done hereinbelow, on some of the more impactful signs of impending bad times.

Cash is the uncrowned king of the financial sector. It does not lie. Anyone that takes his/her eyes off the cash situation and cash flow, even fleetingly, ends up paying a very high price. Inexplicable volatility in the figures relating to cash constitute, without argument, a very major warning signal.

The structure of a corporate group is often the root cause of its problems. There is enough evidence to show that while things might seem alright in the parent company, subsidiaries are the preferred vehicles for fraudulent activities. Directors need to look at structures, the number of layers involved, and the reporting relationships that hold the structure together. Intercorporate transfers, without rhyme or reason, and improperly priced, is often a clear giveaway that there is something that does not meet the eye.

Of equal import is the patchy track record in meeting statutory dues and payments to lenders, vendors and other creditors. While defaults bring with them penalties and prohibitions, the larger picture that emerges is one of inability, and on occasion, unwillingness, to make payments in time, and that clearly is a flashing red light that cannot be ignored.

Attrition of key personnel, especially Key Managerial Personnel (KMPs), should bring with it the presumption that the company is in dire straits. While some exits might be for legitimate reasons, the exit of a KMP at a time when negative news regarding the company is gaining ground, should be a cause for serious concern. The question should arise whether "well-informed rats" are deserting sinking ships.

Audit reports and inspection reports constitute a valuable source of information regarding the health of the company. Companies that do not act on adverse observations are prime candidates for disaster. To use the colourful words of a distinguished Regulator of yore, when it comes to audit and inspection reports, the company and its officials should eschew an attitude of contestability.

The carrying on of business will entail a number of legal cases of different types. While they cannot be wished away, it is useful to subject them to a thorough review to ascertain whether there has been any error or irregularity on the part of the company, with financial consequences that could be destabilising. To ignore adverse rulings in the fond hope that appellate action will be positive, is to willingly suspend disbelief.

Whistle-blowers constitute a very valuable source of information to Directors. Some companies have developed a response mechanism by which anonymous or pseudonymous complaints are ignored, even though the contents are both serious and verifiable. If such a practice is allowed to continue, Directors will soon come to grief by ignoring what are obvious warning signals. While every such complaint is not necessarily genuine, the lack of seriousness in the manner in which complaints are dealt with could give rise to grave issues. The history of corporate meltdowns, both in India and elsewhere, has clearly demonstrated that more often than not, it was some whistle-blower whose conscience lit the spark which engulfed the company in flames. The overarching warning signal is the phenomenon of the executive element of the Board denying related information to the non-executive element of the Board. Treating important developments as operational matters that the Board should not be concerned with, managements have been known to trip up badly when major problems surface. Treating the Board as an avoidable nuisance is a major management falling that Directors, especially IDs, should watch out for, on a continuing basis.

The flow of information is the lifeblood of any organisation. Informed decision-making would require that the Directors are kept apprised in time regarding every aspect that is relevant, in any problem that is being grappled with. Directors bring multiple skillsets and diverse experience to the boardroom. In pursuit of popularity and acceptance by the management, they neither challenge the management, nor ask questions that could elicit more information. Equally problematic is the gullible manner in which all information that is brought to the boardroom, especially through colourful presentations, is accepted as the gospel truth. While there is no place for negativism or obstructionism in a boardroom, it is useful to recognise that healthy scepticism does not hurt. If the essence of the Board-management relationship is one of constructive tension, premised on continuing curiosity and the willingness to engage, the company will benefit immeasurably. Absent these behaviour patterns, companies, that once seemed good, will sooner, rather than later, belong to the dustbin of economic history.

The Bard might forgive the adaptation of his immortal lines:
"The evil that companies do lives after them;
The good is oft interred with their bones."

READERSPEAK - TELLING IT LIKE IT IS

Gopal Pillai, Former Home Secretary, Government of India
"Good article. But will anything change? We are in for difficult times."

SN Talwar, Founder Partner, Talwar Thakore & Associates (TTA)
"Great and thought provoking piece. It hits the nail on the head. Brilliantly captured by you."

Vinita Bali, Former MD, Britannia Industries
"As always...you have told it like it is and packed with valuable insights!"

Vikram Singh Mehta, Executive Chairman, Brookings India and former CEO, Shell India
"Super .. constructive ... elegant."

S Hajara, Former CMD, Shipping Corporation of India
"It's always better to be transparent and truthful as stakeholders don't mind mistakes as much as falsification and suppression of truth."

Milind Kulkarni, Senior Advisor and Former CFO, Tech Mahindra
"This is one of the best communications on 'Communication'"

Do let us know of any specific issues you would like to see addressed in subsequent issues.