

*The halo around some institutions, many of which are large, has deservedly disappeared. The reported transgressions have wrought havoc with individual reputations. So far so good. Now entire communities such as IDs, auditors and rating agencies are being held up to ridicule. While the guilty should be gone after, and punished, the credibility of the system should not be eroded. Through this newsletter, we reach out to the Hon'ble Minister, Corporate Affairs, in the firm belief that matters can be, and will be set right.*

**Editor**

## **An open letter to Minister, Corporate Affairs**



### **M. Damodaran**

*Chairperson, Excellence Enablers  
Former Chairman, SEBI, UTI and  
IDBI*

Hon'ble Minister,

It is with utmost reluctance that I am reaching out to you at a time when you are giving final shape to your first budget as the Union Finance Minister. Ordinarily, I would have held this back. However, with new developments, almost every day, impacting on significant functionaries in the corporate space, I believe that this letter cannot be postponed.

Let me also make the necessary disclosure. I have been, and continue to be, an Independent Director (ID) on the Boards of some large companies. I also happen to be a member of the Board of Directors of a rating agency (the one major agency that did not rate IL&FS).

For some time now, IDs, as a "community", have had to cope with criticism and ridicule as well as attacks on their honesty and intellectual integrity. More recently, the auditing profession and the rating agencies have been added to the ever-expanding list of villains in the Corporate Governance movie.

It is not my case, nor can it be anyone's case, that persons who have acted in a malafide manner and have actively colluded, conspired or connived with management, should be allowed to go scot-free. However, tarring an entire group of professionals with the same brush, can run counter to the stated objective of cleaning up the system.

Let me begin with IDs. The institution of IDs, which was first introduced by SEBI through Clause 49 of the then Listing Agreement, and later given statutory recognition by the Companies Act, 2013, was conceived as an instrumentality to provide a sense of balance in corporate boardrooms. Deriving from the distrust that the system had in promoters, the IDs were expected to ensure that the interests of all stakeholders in a company were addressed in a balanced manner. It is my sincere belief that every attempt should be made to strengthen the institution of IDs, rather than frighten away existing and potential IDs from the boardrooms, or have them function as the opposition party in the boardroom. The perception that IDs cannot be independent or act independently merely because the promoter or other controlling interests, including the Government of India, had something to do with their appointment, is unfair both to the IDs and to the stakeholders, whose interest they are intended to safeguard while promoting the interests of the company. I am not aware whether the Government of India, at a senior level, has engaged with an adequate number of IDs to find pragmatic solutions to the problem of perceived non-independence. Arranging for training programmes which impart knowledge of the laws and the regulations does not travel far enough. Lectures on ethics will also be empty exercises since they are premised on the assumption that mature persons sitting in boardrooms are unaware of what constitutes ethical practices.

It is also useful to reflect on the fact that IDs, because of their non-executive position, suffer from information asymmetry. This problem is compounded by their being overwhelmed, especially in banks, with an extraordinary amount of material, passing for relevant information, dumped on them. These are often in the nature of weapons of mass distraction and prevent focus on the essentials.

There are two specific suggestions I wish to make. Firstly, the process of evaluation of Directors should be undertaken by outside experts who have first-hand boardroom experience, and are not headhunters or general management consultants seeking yet another revenue stream. Secondly, whenever there are allegations that IDs have, either conspiratorially or negligently, aided malafide action by management, they should be looked at by a high level standing committee comprising credible persons, who have spent long years in the boardrooms, to examine whether there is any

prima facie indication of malafide action or inaction by the IDs concerned. This could be a body on the lines of the Advisory Board on Bank Frauds which screened complaints against senior level bankers, and referred to the CBI only such cases as were indicative of prima facie negligence or misconduct, warranting criminal action.

There was a time when the opinion of the auditor was regarded as the ultimate truth. Then Satyam happened and the first signs of doubt and disbelief emerged. The spate of scandals that have come to surface in recent times has severely impacted the credibility of the auditing profession. While there can be no excuse for an auditor who saw something wrong and looked the other way, or whose professional instincts should have helped unearth irregularities, it is necessary to ensure that the reputation of the entire profession is not tarnished. Commercial operations require to be audited to ensure that the interests of the stakeholders are protected. Therefore, while the errant should be brought to book, the credibility of the auditing function requires to be protected and preserved. This is a balancing act that must be attempted with all categories of stakeholders agreeing on what the scope of audit ought to be. Unless this is done, we will witness the spectacle of auditors departing mid-year from companies with which they had a comfortable, if not a cosy, relationship for many years. Auditors that resign should be required to appear before the shareholders that appointed them and explain why they chose to discontinue their engagement. The disclaimers and hedges, behind which some of them hide, should be reduced, even if they cannot be eliminated. Most important however is that representatives of the profession are heard so that no one is punished without factoring in any possible explanation that they might have for alleged omissions or commissions. The expectation that the auditors will identify and bring out every irregularity is misplaced since the function of audit is not to undertake a comprehensive transaction-wise review. As in the case of IDs, it is necessary that an auditor or an auditing firm which is being hauled up is enabled to present its case to a high level professional group (perhaps NFRA) so that an informed view is taken before they are accused of criminal intent and collusion. While examples must be made of the dishonest, it is necessary that the profession is saved from uninformed criticism.

Rating agencies are also presently in the doghouse for rating actions and inactions. While there have been delayed responses to developments that ought to have been responded to earlier, it is perhaps necessary to avoid reading criminality into every rating error. Accountability must be enforced by the functional regulator, which in recent times has considerably tightened the regulatory framework and taken it to levels far higher than those that obtain in the developed world. To straightaway accuse officials of rating agencies as being involved in criminal activities, except where clear evidence exists, is to undermine a value-adding process which has, for the most part, been credible and reliable. Here again, while punishing those that have stepped out of line for the wrong reasons, it is necessary to preserve and protect the entities that perform a critical function that cannot be wished away.

Hon'ble Minister, the recent scandals in the financial sector present an invaluable opportunity to put in place a legal and regulatory framework that is consistent with the objectives that they seek to achieve. While investigative agencies can and must do what they are tasked to do, those responsible for the safety and soundness of the financial sector should, without loss of time, work on a framework that encourages honest decision-making, and comes down with a heavy hand on those with ill-intent. Every crisis, it is said, is an opportunity. I am confident that, in your widely acknowledged pragmatic no-nonsense manner, you will re-engineer the legal and regulatory framework to make it in sync with the need of a healthy confident financial sector.

## **READERSPEAK - The IDentity Crisis**

### **S. Sandilya, Chairman, Eicher Group**

*"Companies which had excellent reputation on governance seem to have had problems. Some of them would have had high quality IDs as well. Did they miss the symptoms or close their eyes and ears? Or the issues were well buried under the plethora of documents presented in the last minute?"*

### **K.K. Srinivasan, Former Member, IRDAI**

*"'Independent Director' is different from 'Quality Director'. Perhaps the issue is not merely of 'independence' but also 'quality'. How do we ensure quality?"*

### **S. Hajara, Former CMD, Shipping Corporation of India**

*"I think there appears to be no clarity of thinking and unless situation improves, the basic purpose of having independent directors may be defeated."*

### **B. P. Vijayendra, Former Principal Chief General Manager, Reserve Bank of India**

*"They certainly do have an important role to play and should do so at all times."*

### **N. Suryanarayanan, Former Head, Group Secretarial and Compliance, L&T Financial Services**

*"I fear that what is not done by self-regulation would lead to ham-handed regulation (by the government). My post-corporate experience tells me that seldom is this aspect given any importance, even in large corporates."*

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

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