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Expert Expressions
Corporate Governance Demystified

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ANNUAL REPORTS AND THE SEARCH FOR ANSWERS

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Stakeholders deserve a better fate,
Than Annual Reports that don't communicate.

It is often said, somewhat irreverently, of statistics, that what it reveals is interesting, but what it conceals is vital. Much the same could be said of many of the Annual Reports that companies make available to shareholders, as a preview to the annual get-together, also called the Annual General Meeting (AGM).

Responding to directions and prescriptive arrangements that, from time to time, require some matter or the other to be included in them, Annual Reports have become far more voluminous than they need to be. The fundamental principle that if more is written, less will be read, seems to have been lost sight of by those that prescribe, as well as those who prepare, Annual Reports. A small font size that is used in footnotes of text, with an asterisk, is also not very helpful.

The starting point of our scrutiny could be the composition of the Boards, and the attendance of Directors at meetings of the Board and its committees, as reflected in the Annual Reports. In some cases, there is no clarity on whether the Chairperson is an Executive or a Non-Executive Chair. Further, in some cases, there is no clarity to which category (Promoter/ Nominee/ Non-Independent/ Independent) a Director belongs. As for attendance, shareholders have a right to know who among those that act on their behalf on Boards and in committees, actually attend many, if not all, of the meetings. If even this information is presented in a manner that confuses rather than conforms, no one will be left any the wiser. Some Annual Reports present the total attendance at Board and committee meetings. Some of those do not indicate how many of them the Director could have attended, in case he/she was a mid-year inductee on the Board. This can be easily addressed if the date of appointment/ cessation is clearly indicated. At least as big an issue is the obfuscation when it comes to providing details of attendance at AGMs. Some proceedings indicate how many Directors were present, but throw no light on how many were absent. It is not always easy to derive this information in the absence of a clear indication of Board composition on the date of the AGM. The silence is stunning when it comes to the attendance of the representative of the majority shareholder in PSUs. The statutory prescriptions that the Chairpersons of the Audit Committees (ACs) and the Stakeholders Relationship Committees (SRCs) should attend, are also addressed circuitously either by the omission of the facts, or by stratagems, such as saying that a proxy holder Director attended the meeting on behalf of these committee Chairpersons. Regrettably, even Secretarial Audit Reports, which are expected to be an affirmation of compliance with laws and regulations, do not flag this non-compliance. Interestingly, even Secretarial Standards -2 mention that Chairs of AC and SRC can authorise another Director to attend the AGM on their behalf, even though SEBI LODR Regulations prescribe that these persons should be present. There are several variations on the theme of withholding information of attendance at AGMs, and they are numerous enough to merit a separate study.

The Management Discussion and Analysis (MDA) Report is yet another area in which a lot is said, but not enough is communicated. Hiding behind language, there are expansive general statements made about the state of the nation, without adequate focus on the sector or the company. Risks that the company faces in its operations do not get comprehensively addressed. Similarly, whereas several numbers are trotted out in regard to human resources, the issues germane to that space are often left inadequately addressed. The adequacy of internal control systems is glossed over.

The increasing focus worldwide on conducting business in a sustainable manner has been sought to be captured in the Business Responsibility Report (BRR), soon to be replaced by the Business Responsibility and Sustainability Reporting (BRSR). Here again, motherhood statements tend to crowd out specific initiatives, which could lend clarity to what the corporate entity is doing as a responsible corporate citizen. What is worse is that often incorrect, irrelevant, and internally inconsistent statements seem to be crowding out factual information in this Report.

With the workload of Boards having increased significantly in the recent past, the workload of the Board committees has also undergone at least proportionate increase. It would therefore be fair to expect that the work done by the committees during the year under report, finds adequate mention. The factual position is that some of the Board level committees, such as Risk Management Committee and Corporate Social Responsibility Committee, do not even find a mention in the Corporate Governance chapters of the Reports of some companies.

Some Annual Reports set out in detail the terms of reference of the various committees, and some others invite a reference to the relevant Section/ Regulation of the Companies Act, 2013/ SEBI LODR Regulations. Even for different committees, there is no standard format in which the terms are captured. The most important information, which is what each of the committees did/ did not do during the year, on the basis of their terms of reference, does not figure in these Reports. Starting from clarity in reporting the composition and attendance at committee meetings, including a clear indication of who chairs/ chaired the concerned committee, much more justice requires to be done in the Annual Report to the work done by the committees during the year.

Corporates conduct their business in accordance with policies that the Boards put in place. These are policies which ought to be appropriately disseminated to shareholders, other stakeholders, and those interested in studying the performance of the company. Some Annual Reports merely provide a reference to the website of the company, leaving it to the information seeker to go on a fishing expedition to discover where the policy that he/she is looking for is available. It should not be rocket science to provide links to the policies, than leaving persons to the tender mercies of the website, that is clumsily constructed, and often not updated. One example is of familiarisation programmes, where the references are to programmes undertaken a few years ago, with no updates of subsequent programmes, if any. This compounds the fundamental error which many companies commit, not unknowingly, of passing off Board presentations, which are a part of the agenda, as familiarisation programmes. Interactions with senior management persons are also included in this category of programmes, giving rise to the question whether in the absence of such interactions, the Directors and the senior management would continue to function, without being familiar with each other.

As for the disclosures relating to Board Evaluation and Succession Planning, the generality of the statements clearly point in the direction of these having been tick box exercises, not intended to be value adding. Some of these do not even find mention in the Annual Reports. The least that can be done is to provide for placeholders for all the mandated items, so that there is at least some token mention, which might persuade serious readers to further explore. A major step forward could be a tabular statement that captures the conclusions of the Board Evaluation exercise and points to the remedial measures taken/ contemplated.

Audit fees is yet another area where what is required to be provided does not find clear mention. Different companies group different kinds of payments to statutory auditors in different manner. The focus of any student of Corporate Governance is the non-audit fees paid to statutory auditors, since such payments could adversely impact on auditor independence. The way these numbers are presented, by combining non-audit fees, with fees for taxation, certification and other services, the search for relevant information is rendered needlessly complicated. There are 3 places in the Annual Report where fees paid to statutory auditors is mentioned - Board report, standalone audited statements and consolidated audited statements. The Board report is expected to mention “the total fees, for all services, paid by the listed entity and its subsidiaries, on a consolidated basis, to the statutory auditor and all entities in the network firm/network entity of which the statutory auditor is a part”. There are, in some cases, inexplicable differences in the numbers mentioned in the Board report and the consolidated audited accounts. This problem is further compounded by some companies mentioning the fee paid to statutory auditors under miscellaneous expenses or legal and audit fees.

Remuneration to Directors, and Key Managerial Personnel (KMPs) is also not provided in a manner that serves the fundamental purpose of determining whether remuneration takes into account the achievement of KRAs. It is universally believed that a significant portion of remuneration of KMPs should be variable pay, linked to performance. When remuneration is given as one number, including therein the fixed element and the variable element, the linkage to the KRAs cannot be easily established. As for remuneration of Directors, there is reasonable clarity on the sitting fees, except in a few cases. However, there needs to be far more clarity on the payment of commission, and whether it factors in contribution of the Director concerned. Contribution brings us to skillsets. From most Annual Reports, it would seem that there is no relevant skill that is missing in the Board. As an extension of this utopian statement, it will also be found that most, if not all, Directors are reported to have all the skills that Boards require in the discharge of their duties. It is a separate point that behaviour, team spirit, maturity and similar factors are far more important than skillsets in performing Boards. As for Directors being appointed on the Boards of PSUs on the basis of skillsets, it is not proposed to travel down the path of what might turn out to be a painful discovery.

Prevention of Sexual Harassment, somewhat inappropriately abridged as POSH, is yet another matter that deserves better treatment in Annual Reports. Figures relating to complaints are given in two different places, and sometimes the numbers do not match. While on the subject of POSH, what would increase credibility of organisational commitment is an indication of the number of programmes that have been conducted, and the number of participants at such programmes. A trend analysis should also be undertaken to determine whether the training programmes have contributed to increased awareness and the creation of a better working environment.

A satisfactory Vigil Mechanism, also referred to as the Whistleblower mechanism, is a factor that helps to ensure that business is conducted responsibly. While the Annual Reports of some companies make the grand statement that access to Chair of the AC was not denied to any person, the contact details, and often the name of the Chair of the AC, is not indicated in Whistleblower policies of those companies.

The Secretarial Audit reports would have the readers believe that all is well with the corporate world, and that there are no shortcoming or infirmities and non-compliances that have surfaced during the process of audit. The few comments that these Reports contain, do not normally feature as observations, thus enabling the Board/management to avoid addressing them in the Board report.

There can be no argument that the Annual Report is an instrument for the Board and the management to communicate effectively with shareholders and other stakeholders. This purpose can be better achieved, than at present, if Regulators and enlightened company managements travel in the direction of having Annual Reports that bring out relevant information in the form of bullet points, wherever possible, without complex sentences compounding the confusion. In the ultimate analysis, Annual Reports must be seen as instruments of effective communication to stakeholders, rather than a ritualistic response to the provisions of the Companies Act, 2013 and SEBI LODR Regulations.

THE STORY SO FAR...

Timelines for dissemination of Annual Report to shareholders

Jurisdiction	Provisions
Australia	Earlier of: (a) 21 days before the next AGM or (b) 4 months after the end of Financial Year
Canada	At least 21 days before the date of AGM
Germany	Not later than 4 months after the end of each Financial Year
Hong Kong	At least 21 days before the date of AGM
India	At least 21 days before the date of AGM
Malaysia	Not later than 4 months from the close of Financial Year
Singapore	At least 14 days before the date of AGM
South Africa	At least 15 business days before the date of AGM
UK	At least 21 days before the date of AGM
US*	60 days after the end of fiscal year

**In US, NYSE listing rules have been considered*