CHAPTER III

CORPORATE GOVERNANCE WATCH

3.1 Corporate Governance

Corporate Governance generally refers to practices by which organisations are directed, controlled and held to account. The absence of good governance structure or the non-adherence to the governance principles would increase the risk of public corruption and misuse of entrusted power by the management in public sector.

3.1.1 The CAG of India as the government auditor plays an important role in ensuring effective public sector governance. The significant findings and recommendations as conveyed in the Audit Reports represent critical inputs to good governance that can lead organisations to take prompt and appropriate corrective actions to remedy identified weakness and deficiencies. The principles of accountability, transparency, probity, equity and fairness are reviewed, examined and audit observations thereon are reported by CAG in the various Audit Reports including Reports on the performance of selected critical activities/aspects of Public Sector Undertaking with suitable recommendations.

3.2 Corporate Governance Policy

The amendments to Sections 217 and 292 of the Companies Act, 1956 (made applicable from December 13, 2000) set the tone for Corporate Governance in the country.

3.2.1 The extant government policy envisages a strong and effective public sector which would be encouraged to enter the capital market. There is also a need for public accountability of public sector management regarding its duties and responsibilities. Good corporate governance practices enhance companies' value and stakeholders' trust resulting in robust development of capital market, the economy and also help in the evolution of a vibrant and constructive shareholders' activism.

3.3 Formation of Audit Committee

Section 292A of the Companies Act, 1956 requires every public limited company having paid up capital of not less than rupees five crore to constitute an Audit Committee at the Board level. The terms of reference of the Audit Committee include all matters related to financial reporting process, internal control and risk management system of the company, overseeing the audit process and performing other duties and responsibilities as assigned by the Board.

3.4 SEBI's Guidelines on Corporate Governance for listed companies

The Securities and Exchange Board of India (SEBI) by its Circular dated 21 February 2000 directed Stock Exchanges to amend the Listing Agreement between them (i.e., stock exchange) and entities whose securities were listed and to include a new clause 49 in such Listing Agreement. This clause was amended in October 2004 and the revised clause has been made effective from 1 January 2006. Clause 49 of the Listing Agreement among other things specifies that a qualified and independent Audit Committee shall be set up giving the terms of reference.

3.4.1 According to the Clause 49II(D)(4) of Listing Agreement, the Audit Committee is mandated to review the annual financial statements before submission to the Board for approval, with particular reference to matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (2AA) of section 217 of the Companies Act, 1956. Thus, the Audit Committee has to oversee company's financial process and disclosure of its financial information etc.

3.4.2 So far as composition of the Board of Directors of listed government companies is concerned, where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise independent directors and in case he/she is an executive director, at least half of the Board should comprise independent directors.

3.5 Independent Directors on the Board of listed government companies

The Board is the most significant instrument of Corporate Governance. The presence of independent representatives on the Board, capable of challenging the decisions of the management, is widely considered as a means of protecting the interests of shareholders and other stakeholders.

3.5.1 Keeping in view the importance and role of independent directors in the good governance of companies, a review was undertaken in respect of all listed government companies with the objective of assessing the compliance with the provisions of Clause 49 of the Listing Agreement relating to independent directors on the Board. This review was primarily based on the information and documents obtained from the management of the companies concerned. The review of composition of the Board of listed government companies (excluding five deemed government companies covered by Section 619B of the Companies Act, 1956) revealed that the Board did not have the required number of independent directors on the Board of listed government companies given below

Sl. No .	Name of the company
1.	Andrew Yule & Company Limited
2.	Balmer Lawrie Investments Limited (No Independent Director)
3.	BEML Limited
4.	Bharat Electronics Limited

5.	Bharat Heavy Electricals Limited
6.	Bharat Petroleum Corporation Limited.
7.	Chennai petroleum Corporation Limited
8.	Dredging Corporation of India Limited
9.	Hindustan Petroleum Corporation Limited
10.	Indian Oil Corporation Limited
11.	Madras Fertilizers Limited
12.	Mangalore Refinery and Petrochemicals Limited
13.	NTPC Ltd
14.	Power Finance Corporation Limited
15.	Rashtriya Chemicals and Fertilizers Limited
16.	Scooters India Limited (No Independent Director)
17.	Steel Authority of India Limited

Thus, out of 47 listed government companies, the Board of 17 companies had not been constituted as per clause 49 of the Listing Agreement.

3.6 Composition and functioning of Audit Committee

Clause 49II(A)(i) of the Listing Agreement requires that the Audit Committee shall have minimum three directors as members, of which two-thirds of the members shall be independent directors. The requirement of Audit Committee brings into sharp focus the primacy of independent directors in corporate governance and the critical role of financial reporting in meeting the expectations of stakeholders. Further, Clause 49II (A) (iii) of the Listing Agreement stipulates that the Chairman of the Audit Committee shall be an independent director. The non compliance of both the clauses was noticed in following companies.

Sl. No.	Name of the company
1.	Balmer Lawrie Investments Limited
2.	Madras Fertilizers Limited
3.	Scooters India Limited

3.7 Meetings of Audit Committee

Clause 49 II (B) of Listing Agreement requires that the Audit Committee should meet at least four times in a year and not more than four months shall elapse between two meetings. During review, it was noticed that Madras Fertilizers Limited, no Audit Committee meeting was held during 2009-10.

3.8 Audit Committee in listed government companies

Keeping in view the important role of the Audit Committee in good governance of an entity, a review on the functioning of Audit Committee of listed central government companies was conducted to assess effectiveness. During review, it is noticed that some of the Audit Committee of listed Government companies contributed considerably towards improvement in financial reporting, accounting policies, internal control system, analysis of non moving inventories etc and ensured credibility of financial statements. For example, in respect of NTPC Limited, the committee observed that there was widespread variation in elements of cost in various stations. The committee advised that whenever costs were lower, reasons for such lower cost including practices followed be analysed and the possibility of replicating such practices in other projects/stations be explored. The committee suggested mechanisms should be in place for reduction/early settlement of large number of pending arbitration cases.

3.9 Chairman's attendance in the Annual General Meeting

Clause 49II (A)(iv) of Listing Agreement requires that the Chairman of the Audit Committee should be present at Annual General Meeting (AGM) to answer shareholder queries. However, the Chairmen of the Audit Committees of the following companies neither attended nor nominated any other member of the Committee to attend the AGM held during 2009-10:

Sl. No	Name of the company
1.	Hindustan Photofilms (Manufacturing) Company Limited
2.	Hindustan Fluoro Carbons Limited
3.	HMT Limited
4.	Scooters India Limited

3.10 Whistle Blower Mechanism

Clause 49II(D)12 of the Listing Agreement also requires the Audit Committee to review the functioning of the 'whistle blower mechanism' in case the same exists in the company. The Listing Agreement contemplates that the company may establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimisation of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organisation.

3.10.1 As whistle blower mechanism did not exist in the following nine companies, Audit Committee did not get the opportunity to review its functioning:

Sl. No.	Name of the company
1.	Andrew Yule & Company Limited
2.	Bharat Electronics Limited
3.	Container Corporation of India Limited
4.	Hindustan Photofilms (Manufacturing) Company Limited
5.	ITI Limited
6.	KIOCL Limited
7.	National Mineral Development Corporation of India Limited
8.	NHPC Limited
9.	The Fertilizer and Chemicals Travancore Limited

3.11 System of preparation of Annual Report on the working of the Audit Committee

During review, it was noticed that there was no system of preparation of annual report on the working of Audit Committee in the following companies:

Sl. No.	Name of the company
1.	Balmer Lawrie Investments Ltd
2.	Dredging Corporation of India Limited
3.	Hindustan Petroleum Corporation Limited
4.	ITI Limited
5.	National Mineral Development corporation of India Limited
6.	NHPC Limited
7.	The Fertilizer and Chemicals Travancore Limited

3.12 System of review of anti-fraud and anti-corruption policies and procedures

The term "fraud" refers to an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. The responsibility for the prevention and detection of fraud rests with those charged with the governance and management of the entity. Management, with the oversight of those charged with governance, needs to discharge this responsibility through the implementation and continued operation of an adequate system of internal control. As such, Audit Committee should review anti-fraud and anti-corruption policies and procedures of the company to reduce the possibility of fraud. However, in the following three companies, Audit Committee did not review the anti-fraud and anti-corruption policies and procedures:

Sl.No	Name of the company
1.	KIOCL Limited
2.	The Fertilizer and Chemicals Travancore Limited
3.	ITI Limited

3.12.1 According to the management of Neyveli Lignite Corporation, BEML Limited, Dredging Corporation of India Limited and Andrew Yule & Company Limited the review of anti-fraud and anti-corruption policies and procedures was being taken care by their own Vigilance Department which followed the directions of Central Vigilance Commission.

3.13 Training and development:

Clause 49 of the Listing Agreement contemplates that a company may train its Board members in the business model of the company as well as the risk profile of the business parameters of the company, their responsibility as directors and the best ways to discharge them. However, no system of providing training to the members of Audit Committee in the following ten companies was observed during review:

Sl. No.	Name of the company
1.	Andrew Yule & Company Limited
2.	Balmer Lawrie Investments Ltd
3.	BEML Limited
4.	Hindustan Fluoro Carbons Limited
5.	Hindustan Photofilms (Manufacturing) Company Limited
6.	HMT Limited
7.	ITI Limited
8.	NHPC Limited
9.	Scooters India Limited
10.	The Fertilizer and Chemicals Travancore Limited

3.14 Conclusion

3.14.1 Since the power of appointment of director vests with the Government, induction of the requisite number of independent directors on the Board should be ensured in the central government companies.

3.14.2 It is essential that members of Audit Committee should have sufficient training to enable them to keep themselves abreast of all developments relating to operational and financial issues specific to the company and industry and updates of new accounting, auditing and regulatory standards. PSUs should provide required training to the members of Audit Committee to enhance their financial literacy, orient them with the risk profile enabling them to fulfill their fiduciary responsibilities.

3.14.3 To enhance the quality of corporate governance, it is important that the Audit Committee should function strictly according to the stipulations of the Listing Agreements. An annual report highlighting the improvement that took place in the financial reporting, internal control system, internal audit system and overall performance of the company as a result of existence and functioning of the Audit Committee, may be prepared and enclosed with the annual accounts of the company to provide information about the working and effectiveness of the Audit Committee.

New Delhi
Dated: 8 December, 2010

(SUNIL VERMA)
Deputy Comptroller and Auditor General
and Chairman, Audit Board

Countersigned

New Delhi
Dated: 8 December, 2010

(VINOD RAI)
Comptroller and Auditor General of India