

CHAPTER-III THEMATIC AUDIT

Corporate Governance in State Government Companies

Executive Summary

Himachal Pradesh General Industries Corporation Limited (HPGIC) is the only listed Company in the State. Though the consent for delisting the Company has been accorded in September 2002 no action to de-list has been initiated so far. Further no discussions were held by Audit Committee with auditors during the period from 2007-12 as required under section 292 A of the Companies Act, 1956 and clause 49 II (D) of the Listing Agreement.

In three companies the meetings of Board of Directors were held after a delay ranging between 27 days and 146 days. Against total four annual meetings of the BOD required, the HPTDC had only two meetings each during 2007-08, 2008-09 and 2010-11 and three meetings each during 2009-10 and 2011-12.

There were delays in holding AGMs in eight companies ranging between 3 (Three) and 30 months. In four Companies absence of internal audit system commensurate with the nature and size of business of the Company since 2007-08 was also commented by the Statutory auditors. Further in three Companies appointment of Company secretaries were in contravention of the provision of Companies Act, 1956.

Introduction

3.1 Corporate Governance refers to the set of systems, principles and processes by which a Company is governed. These provide the guidelines as to how the Company can fulfil its goals and objectives in a manner that add to the value of the Company and are also beneficial for all stakeholders in the long term. The management of the Company assumes the role of a trustee for all the other stakeholders. The absence of good governance structures and lack of adherence to the governance principles increases the risk of corruption and misuse of entrusted power by the management in public sector.

Corporate Governance legislations

3.2 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. The changes relate to the following:

Directors' Responsibility Statement [Section 217 (2AA)]:

3.2.1 With a view to increase the accountability of Directors, a Company is required to include a Directors' Responsibility Statement in the Report of the Board of Directors (BOD) which should affirm the following:

- The Annual accounts have been prepared in accordance with applicable accounting standards with proper explanations relating to material departures;
- The selection and application of Accounting Policies by the Directors is consistent and prudent so as to exhibit a true and fair view of the state of affairs of the Company;
- Proper and sufficient care has been taken by the Directors for the maintenance of adequate accounting records for safeguarding the assets of the Company and for preventing and detecting frauds and irregularities; and
- The Annual accounts of the Company are prepared on a 'going concern basis'.

Formation of Audit Committee:

3.2.2 Section 292A of the Companies Act, 1956 provides that every public limited company having paid up capital of not less than rupees five crore shall 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.

Scope of Audit

3.3 Out of 17 working Government companies, Audit reviewed matters relating to corporate governance of 12 companies (one¹ listed and 11² unlisted) covering the period from 2007-08 to 2011-12. Audit findings are discussed in the subsequent paragraphs:

¹ HPGIC.

² (i) HPSFDC (ii) HPSCSC (iii) HPSHHC (iv) HPPCL (v) HPPTCL (vi) HPTDC (vii) HPMC (viii) HPSIDC (ix) HPMFDC, (x) HPSEDC and (xi) HPAIC.

3.4 Listed Company

Casual approach in delisting the Company

3.4.1 Himachal Pradesh General Industries Corporation Limited (HPGIC) is the only listed company in the State and its shares have not been traded since 1976. The Company had requested (December 1994) Delhi Stock Exchange (DSE) to de-list it. Security and Exchange Board of India (SEBI) on the request of DSE, accorded (September 2002) consent for delisting the Company subject to compliance of clause 40 A (ii) of the Listing Agreement and Regulation 21 (3) of SEBI Regulation 1997 relating to minimum number of shares to be acquired by the acquirer. No action to de-list has been initiated until February 2012 when the Company requested the State Government to accord sanction of ₹ 11 lakh (including annual listing fee from the year of listing with the DSE, *i.e.* 1976) for delisting process. The State Government advised (March 2012) the Company to do the needful from its own funds. The action in the matter was still pending (June 2012) on the part of the Company due to non-compliance of provisions under clause 40 A (ii) of the Listing Agreement and Regulations 21 (3) of SEBI Regulation 1997.

3.4.2 *Non compliance of various clauses of listing agreement*

- (a) The Company (HPGIC) had not complied with the clause 49 {I(A)} of the Listing Agreement during 2008-12, which envisages that the BOD shall have an optimum combination of executive and non-executive directors with not less than fifty *per cent* of the BOD comprising non-executive Directors. During 2008-12, all the five appointed directors were executive directors and no non-executive director was appointed.
- (b) Further, listing agreement provision regarding publishing of periodical interim statement of its working/earnings in a approved³ format to the Exchange had not been complied with by the Company.

Holding of Meetings

3.4.3 The Director nominated from Financial Institution attended three Board meetings during 2007-08 out of required four meetings. Thereafter, no Director from financial institution was nominated and appointed until 2011-12.

The State Government appointed eight Managing Directors (MD) during 2007-12 to manage day to day affairs of the Company. The tenure of only one

³ Format approved by Exchange (Clause 18), notification regarding meetings of BOD (clause 19), notification regarding change in the status of Company's Directorate, Managing Directors and Auditors (Clause 30) and furnishing of copies of the annual financial results (Clause 31).

MD was more than a year and the tenure of remaining seven MDs ranged between one and five months.

Appointment of Company Secretary

3.4.4 According to Section 383A of the Companies Act, 1956, all Companies having paid up capital of ₹ 5 crore and above shall have a whole time Company Secretary (CS). Audit observed that during April 2007 to June 2009, services of one part time CS were hired by the Company (HPGIC), who was also Internal Auditor/CS of Himachal Pradesh State Civil Supplies Corporation Limited and the services of another part time CS were hired during August 2009 to January 2012, who also worked as part time CS in Himachal Pradesh Agro Industries Corporation Limited.

Whistle Blower Policy

3.4.5 Clause 49 II (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 (HPGIC). The Listing Agreement contemplates that the Company may establish a mechanism for employees to report to the management the 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.

The Company did not establish any mechanism for employees to report to the management about unethical behaviour, actual or suspected fraud or violation of the Company's code of conduct or ethics policy.

Audit Committee

3.4.6 Audit Committee was constituted in July 2001 after issuance of amendment *vide* Notification in December 2000 making the constitution of Audit Committee mandatory in order to establish good corporate governance in the country. Further, as *per* the Sub-Section 6 of Section 292 A of the Companies Act, 1956 and Clause 49 II (D) of the Listing Agreement, Audit Committee should have discussions with auditors periodically about internal control systems, scope of audit including observations of the auditors and ensure compliance of internal control systems. Audit noticed that no such discussions were held by Audit Committee with auditors during the period from 2007 to 2012. Further, Audit Committee had neither given any recommendations nor a system of preparation of Annual Reports on its working was introduced as required under the provisions *ibid*.

3.5 Un-listed Companies

Meetings of the Board of Directors.

3.5.1 Section 285 of the Companies Act, 1956 provides that the Board of Directors of a Company shall meet at least once in every three months and at least four such meetings shall be held in a year. Audit observed that in three Companies⁴, the meetings were held after a delay ranging between 27 days and 146 days. Besides, the Himachal Pradesh Tourism Development Corporation Limited (HPTDC) held only 2 meetings each in a year during 2007-08, 2008-09 & 2010-11 and three meetings each during 2009-10 and 2011-12 instead of requisite four meetings in each year.

Further, Companies registered under Section 25 of the *ibid* Act Himachal Pradesh Minority Finance and Development Corporation Ltd (HPMF&DC) and Himachal Pradesh State Electronic Development Corporation Ltd (HPSEDC) are also required to hold at least one meeting within every six calendar months and two meetings in a year as *per* provision under Section 285 of the Companies Act, 1956. Against this HPSEDC held only one meeting each during 2009-10 and 2010-11 and HPMF&DC held one meeting during 2010-11 against the requirement of two meetings in a year.

Attendance of the Directors in the meetings of the Board/Annual General Meetings (AGM)

3.5.2 The attendance of the Directors nominated by Central Government and Financial Institution in the Board meetings/AGMs of the companies was not regular in following three cases:

- Directors nominated by the Central Government in HPMC had attended only one Board meeting during 2007-12;
- Directors nominated by the Central Government as well as by the Financial Institution in H.P. Agro Industries Corporation Limited and HPMF&DC never attended any meetings/AGMs.

As the Directors are the nominees of the Government to the Board, their absence defeated the very purpose of their nomination.

Annual General Meetings (AGM)

3.5.3 Section 166 read with Section 210 of the Companies Act, 1956, *inter alia* provides that the AGMs are to be held at the earliest of the following dates:

- 15 months from the date of last AGM;

⁴ HPMC, HPSCSC and HPSH & HC.

- The last day of the calendar year; and
- Six months from the close of the financial year.

The earliest of above happens to be six months from the close of the financial year. Audit observed that eight Companies held the AGMs belatedly, *i.e.*, beyond six months from the date of close of financial years during 2007-11. The delay beyond six months ranged between 3 and 30 months, as detailed below:-

Sl.No	Name of Company	2007-08	2008-09	2009-10	2010-11
		(In months)			
1	Himachal Pradesh State Forest Development Corporation Limited	30	23	18	7 (up to April 2012)
2	Himachal Pradesh State Handicrafts and Handlooms Corporation Limited	3	4	3	-
3	Himachal Pradesh State Electronics Development Corporation Limited	3	3	9	-
4	Himachal Pradesh Tourism Development Corporation Limited	3	3	3	3
5	Himachal Pradesh State Industrial Development Corporation Limited	-	-	-	3
6	Himachal Pradesh Minority Finance and Development Corporation Limited	13	6	9	3
7	Himachal Pradesh State Civil Supplies Corporation Limited	3	-	-	-
8	Himachal Pradesh Horticulture Produce Marketing and Processing Corporation Limited	4	3	4	3

The reason for delay in holding AGMs was mainly due to late finalisation of Annual accounts.

Vacancy Position and frequent changes of Managing Directors

3.5.4 Three⁵ Companies did not have whole time Managing Directors during April 2007 to March 2012. During this period, the charge was held by the Managing Directors or Head of the Departments of other State Government Companies/Departments as additional charge. Similarly, whole time Managing Directors of three⁶ Companies also held the charge of other organisations during April 2004 to March 2012.

3.5.5 *Appointment of Company Secretary (CS)*

- (a) Three Companies⁷ had hired the services of CS on fixed/monthly remuneration basis, who were also the whole time or part time CS of other State PSUs/Central PSUs.
- (b) Clause 11 of the Chartered Accountants Act, 1949 First Schedule Part I) prescribes that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage.

Audit noticed that the Himachal Pradesh State Civil Supplies Corporation Limited had hired the services of one CS during April 2007 to February 2011 who was also its Internal Auditor (a qualified Chartered Accountant) in contravention to *ibid* provision.

Internal Audit

3.6 Internal Audit has been recognized as an aid to the higher management for monitoring the financial performance and effectiveness of various programs, schemes and activities. Internal Audit also provides reasonable assurance that the operations are carried out effectively and efficiently, reliable financial reports and operational data and the applicable laws and regulations are complied with so as to achieve organisational objectives.

Statutory Auditors (Chartered Accountants) are required to furnish a detailed report upon various aspects including internal control/ internal audit system of the companies audited in accordance with the directions issued by the CAG to them under Section 619 (3) (a) of the Companies Act, 1956 and to identify areas which needed improvement. In compliance to this, the Statutory Auditors had regularly commented the absence of internal audit

⁵ HPSEDC (4/2007 to 11/2008 and 3/2009 to 5/2011), HPTDC(4/2007 to 9/2010) & HPMF&DC (12/2008 to 9/2009 and 11/2010 to 3/2012).

⁶ HPSIDC(4/2007 to 1/2008 and 9/2008 to 3/2012), HPSCSC (2/2011 to 3/2012) & HPMC (4/2008 to 3/2012).

⁷ HPAIC, HPSEDC and HPH&HC.

system commensurate with the nature and size of business of four⁸ company since 2007-08.

Despite repeated comments from the statutory auditors, no improvement has been made in this regard.

Conclusion

- Since the power to appoint Directors vests with the Government, induction of the requisite number of Independent Directors on the Board should be ensured in the State Public Sector Undertakings.
- Audit Committee did not have discussions with the statutory/internal auditors on important issues of internal control/internal audit before commencement and after completion of audit.
- Meetings of the Board of Directors as well as Annual General Meetings were not held regularly in eight Companies and attendance of Directors was also not satisfactory.
- In case of three Companies, appointment of Company Secretary was in contravention of the provisions of the Companies Act, 1956.
- Non existence of Whistle Blower Policy in listed Company had deprived the employees from the benefit of safeguarding them against any possible victimisation.
- In four Companies, the internal audit system was not commensurate with the nature and size of business despite repeated comments made by the Statutory Auditors.

The matter was referred to the Companies/Government in July 2012; their replies were awaited (November 2012).

⁸ HPAIC, HPMC, HPSFDC and HPTDC.