Grant Thornton
An instinct for growth™

Rebuilding investors' confidence through effective governance

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Foreword

For internal audit leaders, the new normal is to assume nothing is normal. A new door for internal auditors has now opened to change the status quo and transform operations – the digital way.

The country witnessed increased M&A activity in 2017, growing at 53.3% to $77.6 billion in 2017. Companies in India raised INR 1.6 trillion ($24.96 bn) through the primary market in 2017. As a result, investor confidence has improved, reflected in India's entry in the top 100 in the World Bank's 'Ease of Doing Business' rankings. India also maintained a healthy growth rate of about 7% in 2017 and the fiscal deficit decreased to 3.2% of the GDP. On the regulatory front, SEBI Kotak Committee and Companies Act 2013 (the Act) introduced far-reaching changes to enhance transparency in financial reporting. Section 138(1) of the Act has given statutory recognition to the function of internal audit.

An increasingly complex business environment, characterised by growing expectations and demands from the board, audit committee and all relevant stakeholders necessitates a more balanced mix of audit professionals and business executives. For internal audit leaders, the new normal is to assume nothing is normal. Transformation, especially as a result of technology, is inevitable in increasingly integrated global economies, where the future of internal audit looks both promising and challenging as companies come to grips with digitalisation.

The internal audit function needs to change the status quo and integrate planning, execution and reporting with new methods and skills. Regardless of the approach, there will be risks around data security, cyber, business resilience, third-party management, data sharing, governance and budgeting. This is where Robotic Process Automation (RPA) and Cognitive Intelligence (CI) can enable automation of repetitive tasks and accelerate reporting with integrated set of analytical capabilities to audit with advanced technologies.

These developments present an opportunity for the internal audit function to act as an independent adviser to the management and support the management's goals, monitor enterprise risk and enhance regulatory compliance efforts. The function needs to be agile in the adoption of new methods. Transformed operations on the part of internal auditors is a requisite to remain relevant to stakeholders and improve their responses to constantly evolving business disruption. This paradigm shift would further satisfy stakeholders, who depend on internal auditor's objectivity and independent advice to address advanced challenges.

In this report, we dissect some of the critical aspects impacting investors' confidence in company formations and cover the regulatory directives towards enhancement of long-term shareholder value. It includes experiences of companies and addresses common questions around why good corporate governance and internal controls are necessary, not only in order to gain credibility and trust, but also as a part of strategic management for survival, growth and consolidation.

I hope you find the report informative and look forward to hearing from you.

Vishesh C Chandiok
Chief Executive Officer
Grant Thornton India LLP

Overview

India Inc. has grown by leaps and bounds in recent years. As a result, corporate India's attention has evolved from simple 'management' to 'governance' and now 'effective governance'. Many scandals have rocked India's corporate landscape, seriously shaking the confidence of investors. This surge in the instances of failure of corporate governance structure has raised serious questions about the role of the boards and compliance irregularities. In June 2017, the Securities and Exchange Board of India (SEBI) formed a high powered committee under the leadership of Uday Kotak (Kotak Committee) to elicit recommendations to improve the standards of corporate governance of listed companies in the country. On 28 March 2018, SEBI's board accepted 69% of the recommendations.

The final assent to corporate governance practices in the effective management of a company came through new significant provisions introduced in the Companies Act, 2013 (the act) in the form of Independent Directors (IDs), women directors on the board, Corporate Social Responsibility (CSR) and mandatory compliance of Secretarial Standards issued by Institute of Company Secretaries of India as per Section 118 of Companies Act, 2013. The provisions were further strengthened in the Companies (Amendment) Act 2017. The provisions obligate companies to ensure that all stakeholders get their fair share of the firm's earnings and assets and involve a commitment to run businesses in a legal, ethical and transparent manner. This dedication must come from the very top and permeate throughout the organisation.

The Act also strongly emphasises on internal controls and casts a responsibility on the board for overseeing it. Under clause (e), sub-section (5), Section 134, of the Act, Internal Financial Controls (IFC) are defined in the widest possible manner to encompass anything and everything that a company does. The Institute of Chartered Accountants of India (ICAI) issued an updated 'Guidance Note on Audit of Internal Financial Controls over Financial Reporting or ICFR' in September 2015. Boards of listed companies and many specified unlisted companies are required to affirm in the Directors' Responsibility Statements in Annual Reports that IFC systems in the companies are adequate and operationally effective. Statutory auditors too are required in Section 143 to report on the adequacy and operational effectiveness of IFC.

Transition to Indian Accounting Standards (Ind AS) in Indian companies to standardise financial reporting in line with global International Financial Reporting Standards (IFRS) has added another flag to the effective corporate governance mechanisms. On 17 May 2016, ICAI also issued a new Standard on Auditing (SA) 701, Communicating Key Audit Matters in the Independent Auditor's Report. This highlighted that the scope of good corporate governance solutions has further widened. This is due to increasing conflict between ownership and management disciplines and the non-compliance of financial reporting by auditors. As a result, investors suffer heavy losses and loose trust in the financial viability of the company and its ethical standards.

As regulatory and legal recourse in India is still at the developmental stage, it puts the burden of due diligence review on companies and makes the implementation of corporate governance and internal controls a top priority.

The board of directors: Business core

Corporate governance is an integral part of an effective risk management activity of any organisation and should be stringently adopted. It will lead to increase in shareholder's wealth, increase in investors' confidence and reduced cost of capital, along with other benefits of brand equity, greater employee morale and greater confidence of lenders and creditors.

The board of directors is one of the most crucial aspects of any organisation's corporate governance framework. The institution of independent directors on the board of Indian companies and that of the CFO/company secretary in the executive management is designed to create checks and balances and uphold transparency with accountability in decision-making. Both have legal, fiduciary and professional responsibilities apart from ethical considerations to govern their decision-making. But does it really work that way?

It is, thus, important to understand the concept of directorship to the board of directors followed in India. For many, raising a valid concern tantamounts to no effective task, and, hence, they choose not to say anything. The independent directors, too, are usually chosen on board on the basis of familiarity, and not necessarily merit. For complying with the regulation on having a woman director on board, companies were witnessed to appoint their female relatives as directors, which clearly symbolises the dilution of the effectiveness of the regulation per se.

There needs to be clarity on the role of directors, and they should have the autonomy to fulfill their responsibilities. Lack of incentives for directors to do so makes companies less attractive to independent director and also less competitive.

This severely erodes investor trust, despite the best efforts of governments, regulators and other bodies to further strengthen regulatory frameworks and ensure to design them explicitly to instil investor confidence in capital markets.

More than half of the 2,500 executives from 35 economies which took part in the **Grant Thornton International Business Report (IBR) survey** conducted between February and March 2018 are experiencing growing pressure to collect and respond to the views of wider stakeholders (such as employees, customers, suppliers and investors). **In some markets, including the US, UK, India and South Africa, more than 70% of executives feel that the pressure to increase stakeholder engagement has increased over the past two years.**

As a result, businesses need to determine the right board composition, governance and risk management structure. It is also important to develop effective mechanisms for inviting stakeholder feedback and act on this information – a narrow focus on financials is no longer enough for long-term corporate success. As a board member, it is important to know whether there is enough information to manage and direct business and whether it is subject to sufficient validation.

Addressing these challenges is likely to require a broader-based and more proactive approach to governance and decision-making. Thus, investors at all levels demand greater corporate transparency

in order to assess a company's current position and to better understand its long-term vision and investment value proposition. With the recent changes in the statutes, corporations and directors are under greater investor scrutiny than ever before, in terms of not just their financial scorecard, but also records around setting and practicing strong environmental, social and corporate governance policies. Boards are under increasing pressure from regulators and customers alike to engage more broadly with stakeholders and build their views and expectations into the strategy and management of the business.

There is a risk of proxy agencies at times acting like dominant shareholders and unduly influencing the corporate governance landscape

IBR survey

Over the last two years, there is greater pressure on boards/companies to collect and respond to the views of wider stakeholders (such as employees, suppliers, community, customers and investors).

Country	Strongly agree	Disagree/ Strongly disagree
Global	55.5%	12.6%
Africa	78.1%	14.8%
APAC	43.4%	11.7%
EU	52.6%	19.3%
North America	71.8%	8.2%
Latin America	54.8%	8.9%
Australia	61.8%	2.6%
Canada	60.4%	9.8%
India	79%	2%
New Zealand	58%	0%
South Africa	79%	10%
Spain	55%	14%
UK	80.8%	7.2%
USA	73%	8%

Note: Grant Thornton International's IBR is a survey of both listed and privately held businesses. The data for this report was drawn from interviews with more than 2,300 chief executive officers, managing directors, chairmen and other senior executives conducted between February and March 2018.

Corporate governance gone bad

The need for a dialogue is heightened by the speed at which markets are being disrupted, customer expectations are changing and corporate empires are rising and falling. If the business is in the dark, what do stakeholders think or are relying on?

In recent times, several instances of downright failure of corporate governance have grabbed the headlines. Let us take a look at some of the more prominent cases that have been in the spotlight:

Entity and facts	Impact on investors' confidence
A large airline – Exposé of fraudulent transactions Central Bureau of Investigation (CBI) investigated alleged violation of norms in obtaining international flying licences by the group CEO. They allegedly lobbied for faster clearances, and the removal and relaxation of rules with government servants.	The shares slumped as much as 6.3% (lowest in six months) after the CBI probe.
A leading integrated healthcare delivery service provider – A rather dramatic unfold Four directors on the board appealed to the shareholders to not vote them out. Three of them resigned before the meeting where the matter was to be voted upon, and the fourth was voted off the board. At the core of the controversy was the preference of bids made by the directors regarding the sale of the medical chain.	The stocks hit a multi-year low in intraday trade after the resignation of the promoters. The company's market value more than halved.
An Indian multinational bank – A systematic failure of vigilance An INR 11,000 crore scandal went unchecked for years, raising questions on how public banks undertake their roles. The fact that employees colluded against the interests of the bank and managed to stay under the radar points to a lack of checks and balances. Funds were diverted without being red-flagged by investigative agencies/the tax department.	Shares crashed 10% intraday, eroding close to INR 4,000 crore investor money. Equity-oriented mutual funds were severely hit.
A German automaker – Emissions scandal The company rigged its automobiles to pass quality tests, causing damage to human health and the environment. Due to this roughly $25 billion scandal, the company's sales and stock plummeted to unprecedented lows.	Stock price dipped by 28.6% over five trading days. Large shareholders sought compensation for the plunge.
An American multinational financial services company – Fraudulent transactions by employees on behalf of clients The missteps became public in September 2016 where 5,300 employees were fired and the bank was penalised $185 million. Even before the impact of this had been fully realised, new allegations regarding frauds in auto insurance surfaced in June 2017. Alongside a penalty, the Federal Reserve disallowed the entity to grow its assets until the bank made some changes in its way of functioning.	The stocks sank to a two-and a half year low. The scandal caused reputational and financial harm

Such scandals will not occur if there is complete transparency within companies. It is therefore important to evaluate integrated reporting as a safeguard against corporate governance failures.

Implications and value

There is a need to change the negative perceptions around decisions to 'explain' rather to 'comply with' certain regulatory provisions.

Changes have been brought about in the principles of governance to prevent defalcations and create balances to adhere to the notified regulations. In addition to the ex-post measures, there is a need to institutionalise more efficient ex-ante checks to detect the wrong being commmitted and even more to ensure mechanisms are in place to prevent such wrongs from being committed, as is the manifestations of the recent enactments in statutes.

Now, the spotlight is on an opaque business culture dominated by powerful families, known as 'promoters', and the absence of controls to rein them in. The entrenched power of many business families combines with a weak legal system and offers few protections to whistle-blowers. This has led to a culture where no one wants to oppose a promoter. Thus, failures of corporate governance hurt investor confidence and can impact the shareholders' value. Good governance has several elements, and positively influences investors in several ways. Needless to say, the investor sentiment should be a priority for any company.

A good system of corporate governance has to include several elements of smart business practice:

- A fundamental focus on ethics
- Clear alignment between corporate goals and governance
- Appropriate management strategy
- The right organisational structure
- Effective risk reporting

The right governance structure reassures regulators, employees and investors in more than one way. An organisation can realise the benefits by structuring its risk management practices well.

The following are the basic corporate governance guidelines which oversee risk management:

Reporting: The reports from management to the board should, in relation to the areas covered by them, provide a balanced assessment of the significant risks and the effectiveness of the system of internal control in managing those risks. Any significant control failings or weaknesses identified should be discussed in the reports, including the impact that they have had, or may have, on the company and the actions being taken to rectify them.

Roles and responsibilities: All employees have some responsibility for internal control as part of their accountability for achieving objectives. They, collectively, should have the necessary knowledge, skills, information and authority to establish, operate and monitor the system of internal control.

A changed paradigm

Constitution of audit committee in accordance with the board rules

New requirement
Instead of listed companies, listed public companies should be required to constitute an audit committee.

Companies (Amended) Act 2017

1

Companies (Amended) Act 2017

Selection of IDs having no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters or directors, during the two immediately preceding financial years or during the current financial year

New requirement
With the 2017 Amendment Act, remuneration as director or transaction not exceeding 10% of a person's total income or such amount as may be prescribed will not impair independence.

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Board composition

New requirement
Minimum 6 directors on a board

More elaborate
While having more directors will enable the board to discharge its duties in a robust manner, boards with even directorships may face frequent deadlock situations.

Kotak Committee recommendations

Disclosure of expertise of directors

New requirement
All listed companies will now be required to disclose in their annual report a matrix setting out the competencies that they 'believe' their directors should possess and the skill set that each director 'actually' possesses and additionally, from March 2020, disclose their names in the matrix.

More elaborate
Ensure constitution of a wholesome board

Kotak Committee recommendations

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SEBI accepts the key recommendations of the Kotak Committee

Kotak Committee recommendations

New requirement
The maximum number of listed entity directorships held by a single individual will be reduced from 10 to 8 by 01 April 2019 and to 7 by 01April 2020. Further, any person who is a Managing Director (MD) or a whole-time director in a listed entity can no longer serve as an independent director in more than 3 listed entities.

More elaborate
With effect from 01 April 2020, the top 500 listed companies can no longer have the same individual as the chairperson as well as the MD/Chief Executive Officer (CEO).

There is a stipulation that only a non-executive director would be appointed as a chairperson.

3

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Revised eligibility criteria; exclusion of board inter-locks

New requirement
Persons who constitute the 'promoter group' of a listed company cannot be appointed as independent directors.

More elaborate
Until now, it was common practice for promoters to be independent directors in each other's companies or to appoint relatives as independent directors. This amendment has widened the net of exclusions so as to implement a system of 'true independence'.

Kotak Committee recommendations

Effect on Related Party Transactions (RPTs)

New requirement
Enhanced disclosure of RPTs and related parties to be permitted to vote against RPTs

More elaborate
Related parties will now be allowed to cast a negative vote on RPTs requiring shareholders' approval as such a vote cannot amount to a conflict of interest

Kotak Committee recommendations

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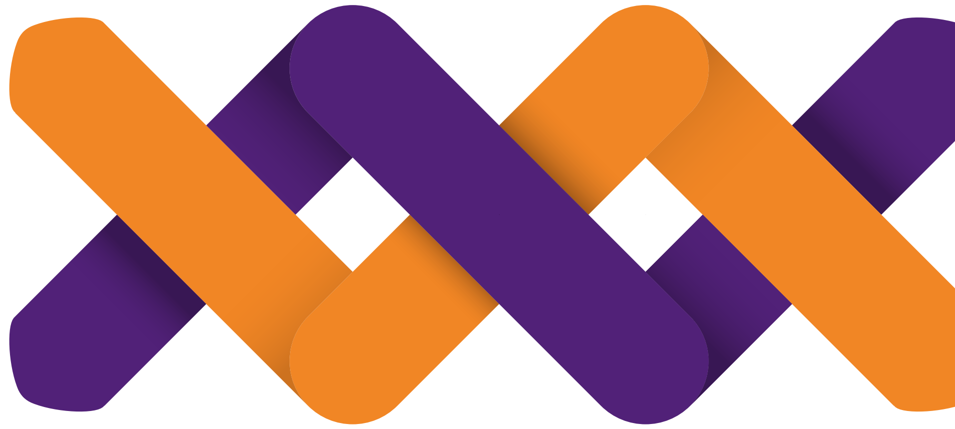
Summary of changes in Companies (Amended) Act 2017

The 2017 Amendment Act has included relaxations, which were earlier available in rules, as part of the act itself. This will address concerns around the rules overriding the 2013 Act.

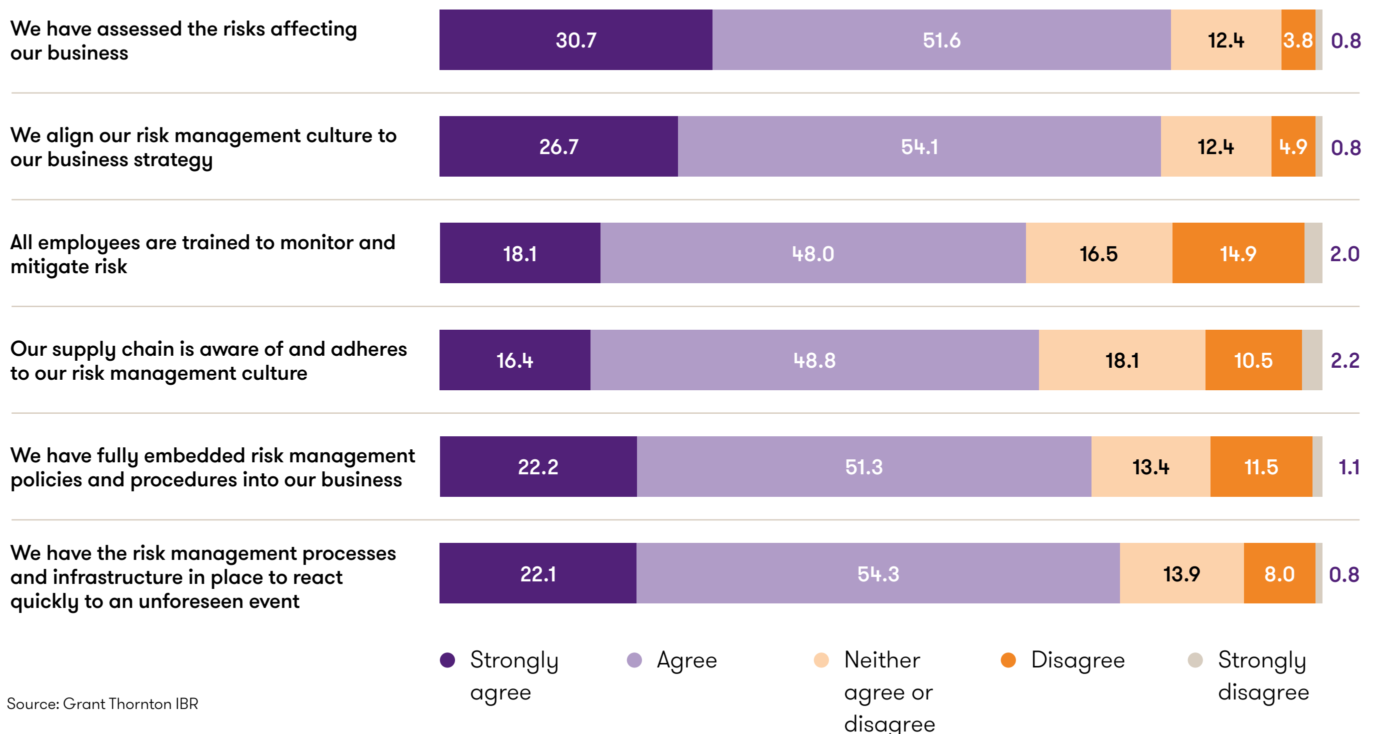
Particulars	Then	Now	Observation
Restrictions on power of the board Sec 180	Sub section (1) clause (c) of the 2013 Act requires that if money proposed to be borrowed and money already borrowed by the company exceeds the aggregate of its paid-up share capital and free reserves, a special resolution is required. The securities premium amount is not included in this computation.	The 2017 Amendment Act amends section 180(1)(c) so that it includes securities premium along with paid-up share capital and free reserves for the calculation of maximum limits on the borrowing powers of the board.	Maximum limits on the borrowing powers of the board are enhanced.
CSR Sec 135	The 2013 Act requires that every company with a net worth of INR 500 crore or more, turnover of INR 1,000 crore or more or net profit of INR 5 crore or more during any financial year will constitute a CSR committee. Such companies should spend, in every financial year, at least 2% of their average net profits made during the three immediately preceding financial years in pursuance of its CSR policy. Further, the said committee will consist of three or more directors, out of which at least one director should be an ID.	The 2017 Amendment Act replaces the words 'during any financial year' with the words 'during the immediately preceding financial year'. Further, where a company is not required to appoint an ID under section 149(4), it will constitute a CSR committee with two or more directors.	The 2017 Amendment Act addresses various practical issues that were arising in the application of CSR-related requirements. Further, the Central Government may prescribe sums which will not be included for calculating net profit of a company under section 135.
Loans to directors Section 185	The section of the 2013 Act provides that a company cannot provide loan, guarantee or security to any of its directors or to any other person in whom the director has an interest.	The 2017 Amendment Act replaces the current requirement of the section with a completely new section 185.	This is a welcome step to address several practical aspects in this regard.
IDs Sec 149	In the 2013 Act, even minor pecuniary relationships may render a person ineligible for appointment as an ID.	The materiality concept has been introduced for determining whether pecuniary relationships impact independence.	The changes will ease the burden of ensuring independence for companies as well as their IDs.
Audit committee pre-approval of RPT Sec 177	Under section 177 of the 2013 Act, the audit committee is required to pre-approve all RPTs and subsequent modifications thereto. In contrast, section 188 requires the board and/ or shareholders to pre-approve only specific RPTs.	If transactions of RPTs between a holding company and its wholly owned subsidiaries require board approval under section 188, then they will also require approval of the audit committee.	The 2017 Act clarifies that if the audit committee does not approve transactions not covered under section 188, it will make its recommendations to the board.



Particulars	Then	Now	Observation
ICFR Sec 134	The director's responsibility statement should, among other matters, state that the directors of a listed company had laid down the internal financial controls to be followed by the company and that such controls were adequate and operating effectively.	No change	There is no requirement to exempt IDs in certifying that the directors have laid down the internal financial controls to be followed by the company.
Appointment of auditors Sec 139	Auditor appointed by the shareholders at the AGM for a consecutive period of five years need to be ratified each year at the AGM.	There will be no requirement for annual ratification of auditor's appointment at the AGM.	The change is supportive of the auditor's independence.
Disqualification for appointment of director Sec 164	Directors may be disqualified from re-appointment in the company or appointment in any other company for a period of five years from the date of disqualification on grounds mentioned in the section.	The 2017 Amendment Act clarifies that if a person incurs disqualification under section 164(2), the office of the director will become vacant in all the companies except the company which is in default under section 164(2).	When a person is appointed as a director of a company which has already defaulted under one or both of the above clauses, then such director will not incur disqualification for a period of six months from the date of appointment.
Penalty on auditors Sec 147	The 2013 Act has not defined the term 'any other person.' Thus, it was noted that the term 'any other person' in sub-section (3) may result in an unintended inclusion of a number of parties	The 2017 Amendment Act has deleted the words 'any other person' in section 147(3)(ii). In place of these words, the words 'members or creditors of the company' have been inserted in sub-section (3)	In case of any wilful contravention by the auditor with an intention to deceive the company/shareholders/ creditors/tax authorities, the penalty is significantly enhanced.
Auditor reporting Sec 143	Companies (Auditor's Report) Order, 2015 requires that an auditor should report on whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act.	The 2017 Amendment Act requires that the auditor of a company will make a statement as to whether the remuneration paid by the company to its directors is in accordance with the provisions of section 197.	It might lead to duplication of reporting.

Extent of agreement towards risk management (Global overview)

For those that do manage their risk, to what extent do you agree or disagree with the following statements (global response)?



Source: Grant Thornton IBR

Do shareholders seem to have a strong focus on corporate governance?

Changes to a company's corporate governance code are usually due to changes in legislation or the reference corporate governance framework. Such changes can also result from requests from the board and shareholders.

The topics of discussion with investors on corporate governance seem to centre around remuneration and the nomination of directors, with issues being raised at various points at ad hoc meetings. It could be argued that if corporate governance links to sustainable business performance, it would be likely to improve investors' confidence as investors would take a greater interest in a broader range of issues including purpose, corporate culture, strategy, risk management and succession-planning.

It is interesting to note that effective corporate governance is directly related to factors such as the skills, personalities and experience of the board members. These factors are, in turn, influenced by boardroom culture.

Many major governance failures turn out to be linked to the existence of a dominant individual whose behaviour went unchecked, leading to poor corporate governance and erosion in reputations and shareholder value. For this reason, a stronger link between ethics and governance is essential to help the company's stakeholders to behave, in their decisions and actions, in a way which is acceptable, reasonable and in conformity with the given values of reference.

How to boost investors' confidence?

Those Charged With Governance (TCWG)

TCWG are the person(s) or organisation(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. For some entities, management includes some or all of TCWG. In some cases, some or all of those charged with governance are involved in managing the entity. In others, TCWG and management comprise different persons. While in some cases, TCWG are responsible for approving the entity's financial statements, in other cases the management has this responsibility.

There is a need for the auditor to determine the appropriate person(s) within the entity's governance structure with whom to communicate. TCWG may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events. However, the auditor shall nonetheless be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity.

Standards on Auditing (SA) 260 recognises the importance of effective two-way communication in an audit of financial statements, provides an overarching framework for the auditor's communication with TCWG, and identifies some specific matters to be communicated with them. Further, SA 265 establishes specific requirements regarding the communication of significant deficiencies in internal control the auditor has identified during the audit to TCWG.

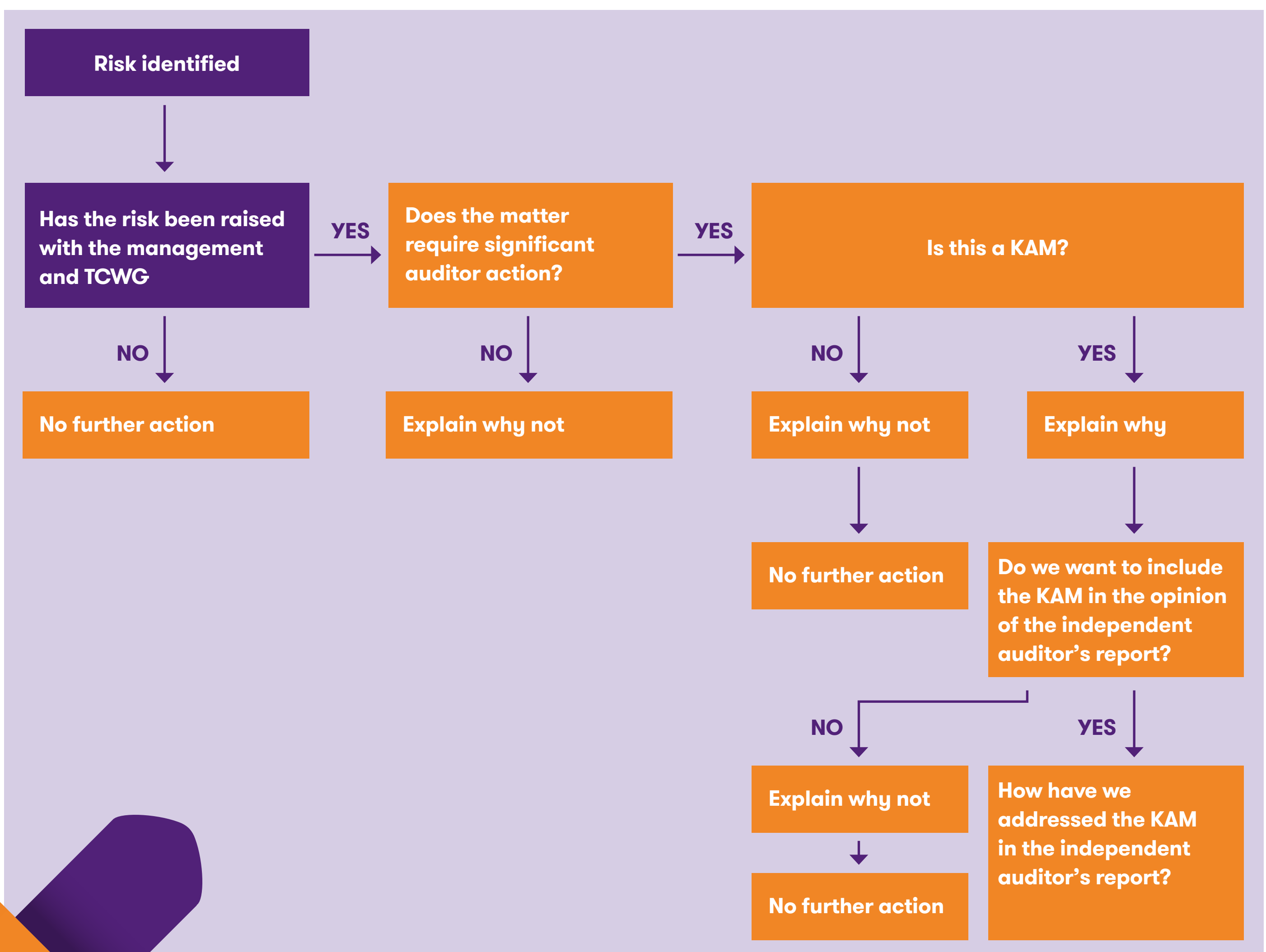
TCWG are responsible to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements. Thus, the objectives of the auditor are to provide TCWG with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process and to promote effective two-way communication between them.

Of importance to note as an auditor here in this context is that when deciding whether there is also a need to communicate information, in full or in summary form, with the governing body, the auditor may be influenced by the auditor's assessment of how effectively and appropriately the subgroup communicates relevant information with the governing body. The auditor may make explicit in agreeing the terms of engagement that, unless prohibited by law or regulation, the auditor retains the right to communicate directly with the governing body.

Inclusion of Key Audit Matters (matters of significance)

Key Audit Matters (KAMs), as defined by auditing standard SA 701, are those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial report of the current period. KAMs should be identified from the matters communicated with TCWG. These matters could, inter alia, include the auditor's responsibilities in relation to the financial statements audit and significant findings from the audit.

From the matters communicated to TCWG, matters that require significant auditor attention are identified which primarily relate to matters that pose challenges to the auditor in forming an opinion or obtaining evidence that in his/her judgement was sufficient and appropriate under the circumstances.



India's transition to Ind AS

New accounting standards are likely to bring more trust among Indian investors

The Indian Accounting Standards (Ind AS) are harmonised with International Financial Reporting Standards (IFRS) to make reporting by Indian companies more globally accessible. With Indian companies having a far wider global reach, the reporting standards were converged with international standards, resulting in Ind AS. A phase-wise convergence is laid down by the Ministry of Corporate Affairs (MCA). The prescribed listed companies in India have started reporting under the new Ind AS from financial year 2016-17.

Ind AS are closer domestic equivalent of IFRS and are considered better than GAAP in terms of disclosures and accounting issues coverage such as derivatives, embedded derivatives, hedge accounting, business combination and control parameters.

While India is converging with IFRS and not adopting IFRS, several carve-outs have been created from IFRS to represent the financials of the companies in the most apt manner. The fact that financial statements under Ind AS are closer to IFRS than previous accounting standards will give foreign investors additional confidence. However, this confidence will be limited by the number of carve-outs from, and amendments to, IFRS.

The new accounting standards are based on the principles of (a) substance over form, (b) fair valuation and (c) increased disclosures in financial statements. However, they provide a lot of discretion on the form of the management's estimates.

For most companies, adopting Ind AS is better accounting. It will lead to increased transparency, better investor relations across the world and reduced costs, especially for multinational companies, as a result of one accounting language. The quality of reporting will be much more superior for Indian companies and there will be international comparability. The Indian stock markets already have a high percentage of foreign owners; that might further increase and the ratios may get better. Reporting under Ind AS or IFRS will elevate the overall confidence in the quality of financial reporting, and the risk premium otherwise getting attached or even the discount getting attached to the reported earnings of the companies will go off, resulting in lower cost of capital.

Thus, the regulators and all stakeholders need to put together a robust system to monitor the quality of financial reporting and at the same time come out with new standards to align with the ongoing accounting change.

Ind AS are based on the principles of

a substance over form
b fair valuation
c increased disclosures

The new significant beneficial ownership rules

The regulations require the corporate veil to be pierced to identify natural persons owning companies in order to close the loop on combating money laundering and terror financing to induce investors' confidence.

The MCA vide its Notification dated 13 June 2018 has enforced the provisions of amended section 90 of the Companies Act, 2013 and also issued the Companies (Beneficial Interest and Significant Beneficial Interest) Rules, 2018. Section 90 has been enforced to identify such individuals who directly or indirectly hold beneficial interest in the company and whose names do not reflect in the register of members as holder of such shares. There is a need to ensure compliance under the provided section in a logical way. It is a collaborative exercise between the company and the Significant Beneficial Owner (SBO).

Once the SBOs are identified, the company is only required to maintain a record of it and file it with the registrar. Where no natural person is identified in case of shareholders being other than natural persons, the senior managing official of the company will be regarded as the SBO. The intent is to have the natural person identified who may be held responsible or accountable in case of suspicious and mala fide activities of the company along with the officers of the company.

As a matter of fact, SBO as a concept is implemented for the avoidance of misuse of 'corporate vehicles', like companies, trusts, foundations, partnerships and other types of legal persons and arrangements, which play a vital role in economy round the globe. These corporate vehicles, in some ways or the other, are misused for unlawful purposes such as tax evasion, money laundering, corruption, insider dealing and other illegal/benami transactions.

Thus, section 90 has been framed more from a Prevention of Money Laundering (PML) perspective. It is highly likely that the natural person declaring as SBO continues to be a benamidar. The real and legitimate owner may not step forward considering the consequence under the Prohibition of Benami Property Transactions Act, 1988. As a matter of compliance with section 90, either the benamidar or in his absence the senior managing official of the company will be regarded as the SBO.

Moreover, SBO exercising significant influence (as defined in Ind AS 28) over the company will be a related party for the purpose of Accounting Standards. And the entity over which the SBO has significant influence shall also be regarded as a related party for the reporting entity.

Overall, the measure ensures that the one who has control or significant influence cannot plead unawareness. Considering the practical difficulty, it may be clarified that each of the upstream/investor companies shall also ensure that disclosure is given by the natural person to the applicable entities. However, it will be difficult for the SBO to declare reasons for not registering shares in their name or direct and indirect percentage of voting rights.

The mandate of the rules is to look through the entire maze of intermediate entities and identify the ultimate individual owners of a company. The ramifications of these disclosures for India Inc is significant and the potency of these regulations cannot be undermined.

Even though there may not be immediate implications of identification of SBOs, the jurisprudence at some stage is expected to hold the SBOs responsible for the deeds of companies.

Role of corporate governance gatekeepers

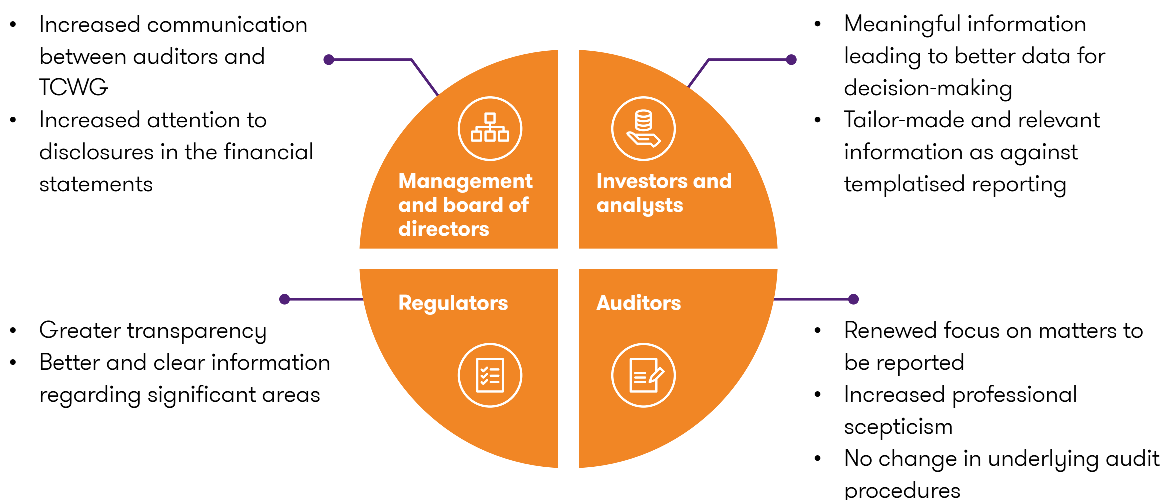
Balance of power-sharing amongst shareholders, directors and management is paramount to enhance the value of the shareholders and protect their interests. This is the primary goal of corporate governance. There is a need of a corporate strategy that is financially, legally and ethically sound. Beyond that, investors like to see responsible and sustainable strategies for attracting investors, a board that has the appropriate background for managing investments, and executives who clearly understand the fundamentals of corporate governance.

Four key gatekeepers

The role of a corporate governance gatekeeper is to align the management's interests with those of long-term shareholders and to protect investors from misleading financial information published in public filings. Misleading financial information could lead to failure of these corporations. The four key gatekeepers of corporate governance are:

1. Independent and competent board of directors
2. Independent and competent external auditor
3. Objective and competent legal counsel
4. Objective and competent financial advisors and investment bankers

Members of an organisation must encourage all to comply with the applicable policies and procedures. The values and norms encompassed in the organisation's corporate culture must be consistent with its standard operating procedures. This would build investors' confidence in these corporations. Considering compliance as a tick in the checklist' is not going to suffice any purpose for that matter.



Our view

Corporate governance is not a trend; it is here to stay. Successive financial crises have heightened political interest to intervene and mandate responses to public concerns considering both corporate governance and financial reporting to be an essential building block for financial intermediation, foreign investment and sustainable economic development.

Indian boards are evolving in a way, and this is a learning curve. The introduction of TCWG with KAM, the ICAI guidance note on internal financial controls framework, periodic amendments in the Companies Act, and convergence of Ind AS with IFRS along with the governance principles and recommendations of the Kotak Committee are the start of more focus on measurement of satisfactory governance to repose investors' confidence. Despite the many cases of bad corporate governance in recent times, progress is underway.

There is a need to go from one extreme to another having asked tough questions from the board; however, the accountability would rest with the management. If genuine entrepreneurs and independent directors keep looking over their shoulders all the time, it would discourage good independent directors from joining boards and will make the Indian industry less competitive globally. Thus, the best way to go about the appointment of IDs is by getting minority shareholders to elect one or even all independent directors so as to protect the interests of the shareholders, especially minority shareholders. Among other things, there has to be a structural shift in the power equation between majority and minority shareholders in areas related to corporate governance as investors may question the ability of directors to fulfil their fiduciary responsibilities when they serve on many boards.

Organisations have started to reflect the importance of shareholders' input into governance practices highlighting that proper regulatory framework and enforcement mechanisms are crucial to promote good corporate governance practices. For every instance of someone getting away with misuse of position, there must exist an example of strict disciplinary action. Therefore, instances of a board exercising its power to remove the top leadership should not be very hard to find.

In the end, corporate governance is about what people in privileged or responsible positions actually do or do not do with other people's (shareholders' and taxpayers') money. Overall, companies worldwide recognise these changing trends and act on them. They recognise the opportunities that come with embracing good governance. For one, this allows them to attract more investors. But good governance also enables companies to gain reputation, which attracts talent, new customers and public recognition.

Needless to say, things have to change now.

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Vishesh C Chandiok,
Chief Executive Officer, Grant Thornton India LLP

Acknowledgements

For further information, please contact

Saket Mehra
Grant Thornton India LLP
M: +91 98990 08822
E: Saket.Mehra@IN.GT.COM

Priyanka Mehra
Grant Thornton India LLP
M: +91 99114 48867
E: Priyanka.Mehra@IN.GT.COM

For media queries, please contact

Spriha Jayati
E: Spriha.Jayati@in.gt.com
M: +91 93237 44249

Editorial review	Design
Tanmay Mathur	Gurpreet Singh

Contact us

To know more, please visit www.grantthornton.in or contact any of our offices as mentioned below:

NEW DELHI
National Office
Outer Circle
L 41 Connaught Circus
New Delhi 110001
T +91 11 4278 7070

NEW DELHI
6th floor
Worldmark 2
Aerocity
New Delhi 110037
T +91 11 4952 7400

AHMEDABAD
7th Floor,
Heritage Chambers,
Nr. Azad Society,
Nehru Nagar,
Ahmedabad - 380015

BENGALURU
5th Floor, 65/2, Block A,
Bagmane Tridib, Bagmane
Tech Park, C V Raman Nagar,
Bengaluru - 560093
T +91 80 4243 0700

CHANDIGARH
B-406A, 4th Floor
L&T Elante Office Building
Industrial Area Phase I
Chandigarh 160002
T +91 172 4338 000

CHENNAI
7th Floor, Prestige Polygon
471, Anna Salai, Teynampet
Chennai - 600 018
T +91 44 4294 0000

DEHRADUN
Suite no. 2211, 2nd floor Building 2000,
Michigan Avenue,
Doon Express Business Park Subhash
Nagar, Dehradun - 248002
T +91 135 2646 500.

GURGAON
21st Floor, DLF Square
Jacaranda Marg
DLF Phase II
Gurgaon 122002
T +91 124 462 8000

HYDERABAD
7th Floor, Block III
White House
Kundan Bagh, Begumpet
Hyderabad 500016
T +91 40 6630 8200

KOCHI
6th Floor, Modayil Centre point
Warriam road junction
M. G. Road
Kochi 682016
T +91 484 406 4541

KOLKATA
10C Hungerford Street
5th Floor
Kolkata 700017
T +91 33 4050 8000

MUMBAI
16th Floor, Tower II
Indiabulls Finance Centre
SB Marg, Elphinstone (W)
Mumbai 400013
T +91 22 6626 2600

MUMBAI
9th Floor, Classic Pentagon
Nr Bisleri factory, Western
Express Highway, Andheri (E)
Mumbai 400099
T +91 22 6176 7800

NOIDA
Plot No. 19A, 7th Floor
Sector – 16A
Noida 201301
T +91 120 485 5901

PUNE
3rd Floor, Unit No 309 to 312
West Wing, Nyati Unitree
Nagar Road, Yerwada
Pune- 411006
T +91 20 6744 8800

For more information or for any queries, write to us at contact@in.gt.com

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