Project Report on

A Study of Corporate Governance Evolution Due To Governance Failures and Expected Changes in COVID-19 Era

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CERTIFICATE

This is to certify that Akanksha Gupta, Roll No: 2K18/EMBA/505, student of Masters of Business Administration (Executive 2018-2020) at Delhi Technological University, Delhi has accomplished the project titled "A Study of Corporate Governance Evolution Due To Governance Failures and Expected Changes in COVID-19 Era" under my guidance and to the best of my knowledge completed the project successfully, for the fulfilment of the course Executive MBA.

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DECLARATION

I, Akanksha Gupta, student of EMBA 2018-2020 of Delhi School of Management, Delhi Technological University, Bawana Road, Delhi – 42 declare that Project Report on "A Study of Corporate Governance Evolution Due To Governance Failures and Expected Changes in COVID-19 Era", submitted in fulfilment of Degree of Master of Business Administration is the original work conducted by me.

The information and data given in the report is authentic to the best of my knowledge. This Report is not being submitted to any other University for award of any other Degree, Diploma or Fellowship.

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EXECUTIVE SUMMARY

This project is done on Corporate Governance Evolution due to governance failures which the world has seen and expected changes to governance framework in COVID-19 Era topic in area of "Corporate Governance". The most challenging job for any organisation is to have a robust Corporate Governance Framework in this extremely competitive global business environment. This report seeks to study of the corporate governance failures in our history, the flaws in their governance, and the regulatory response to such failures. The study will also try to assess the expected changes in governance framework in organisations due to COVID-19. The fraud triangle framework by Joseph T. Wells explains the motivation behind fraud is Incentive/Pressure, Opportunity, and Attitude/Rationalisation. The COVID-19 scenario has provided organisations with all three factors especially with relaxations in regulatory and oversight bodies around the world. This author is an auditor and it is important to for auditors need to utilize their profession scepticism, especially in a force majeure scenario where the pressures of COVID-19 on economy might be a driving factor in financial scams or governance failures. The study will explore the various motivations behind the corporate governance failure of large organisations and aims to develop a questionnaire for auditing clients to identify changes in their governance framework and inconsistencies or red flags in their behaviour.

CONTENTS

CHAPTER 1

Major Corporate Governance Failures

1.1. Enron (US)

The Enron scandal has been one of the largest in the US corporate history. It was revealed in October 2001. Enron was utilizing mark to market (MTM) accounting. The approval to use this accounting method was obtained officially in 1992 from US SEC. The MTM accounting method is used by companies for valuing their financials based on the "fair value" of the firm's assets, which are subject to changes based on change in market conditions. This accounting method was used by Enron to mislead investors by overinflating the company's estimated profits. Special purpose vehicles (SPV) were used by Enron to get loans on Enron's behalf and to hide its mounting debt. By 2001, Enron used 100+ SPVs to hide its debt.

Investors had started to lose confidence in Enron as 2001 ended. Jeffrey Skilling came into the role of CEO in February 2001 after Kenneth Lay retired. Jeffery Skilling then in August 2001 for "personal reasons". Analysts had begun to downgrade Enron's stock rating. The company's first quarterly loss was reported by Enron on October 16. SEC then started an investigation into Enron and its SPVs. The company's earnings (or lack of them) were restated by Enron. It came to light that company had losses of $591 million and debt of $628 million. Enron eventually filed for bankruptcy after Dynegy backed out of its plans to merge with the company. There were multiple reasons observed by experts world over for the downfall of Enron:

1.1.1. Failure of Board of Directors

Enron’s board comprised mostly of directors who were outsiders but had significant ownership and were thought of as some of the best in the industry. Enron additionally had a talented audit committee. In its

2000 review of best corporate boards, Chief Executive included Enron among its top five boards. Collapse of Enron may be construed as failure of corporate governance by the board of directors of Enron. The board failed miserably in its oversight responsibilities. The board had no clue of what the executives were doing. The directors failed to understand the related party transactions between Enron and SPEs. The board flawed in implementing in proper system of control and risk management. The company extensively relied on derivatives for its business. The company's finance committee and board did not have comprehensive background in derivatives to grasp what they were being told.

1.1.2. Faulty Accounting Method

The merchant model of revenue reporting adopted by Enron in respect of providing services in wholesale trading and risk management was Enron's main source of hiding its fraudulent activities. Additionally, mark to market accounting to account for its complex long-term contracts was another key factor.

1.1.3. High Executive Compensation

Enron's compensation and performance management system was focused on only short term earnings to maximize bonuses. Employees constantly looked to start high-volume deals, often disregarding the quality of cash flow or profits to get a higher rating for their performance review. In addition, accounting results were recorded as soon as possible to keep up with the company's stock price. This practice helped ensure dealmakers and the executives receiving large cash bonuses and stock options. Employees had large expense accounts and many executives were paid sometimes twice as much as the competitors.

1.1.4 Audit Committee

When investigations were made into the Enron scandal, it was revealed that the audit committee meetings were very brief meetings that apparently covered large amounts of topics. For example, only a thirty-minute meeting occurred on 21 February, 2001. The company's audit committee had committee no technical expertise to understand or question its auditors for accounting issues about its SPVs. Therefore, the committee failed to review the company's transactions with its SPEs.

1.1.5 Low Ethical Standards

Ethical standards of the company had come down to a very low level with employees indulging in self dealings. Senior executives were selling their holdings in the company while others were buying more and more. Extravagances were rampant. Employees were putting self-interest ahead of the corporate interest.

1.1.6 Stakeholders

Stakeholders of the company including creditors, credit rating agencies and regulators (mainly Securities and Exchange Commission) remained silent spectators until the scam became too evident. They failed to question the wrong accounting policies and faulty business model adopted by Enron.

1.1.7 Whistle Blower Policy

The collapse of Enron could have been averted had the company had a whistle blower policy in place. Sherron Watkins, one of the employees of the company had raised concerns in Enron in 1996 but no notice was taken of her concerns and she was shifted to another department. Only in 2001 when she raised the matter of extensive frauds at SPEs again more vociferously that the scandal came to the surface.

1.2. WorldCom (US)

WorldCom was one of the second largest long-distance phone company in the US. The company applied for bankruptcy under US laws in July of the year 2002. The CEO of the company was Bernie Ebbers then who was famous for his trademark cowboy boots and his ten-gallon hat. He had a larger than life personality. Through his acquisition strategies i.e. through acquisition of other telecom companies, Bernie Ebbers built WorldCom as of one America's leading long-distance telecom company. WorldCom's market capitalization was $175 billion when there was a peak of dotcom bubble. When the bubble burst, companies cut on their spending on telecom equipment and their services. To maintain a mirage of growth and profitability, WorldCom started using accounting tricks for financial reporting. Since the Enron scandal happened in the same year i.e. 2001, therefore, investors had already become wary of the picture WorldCom's CEO was trying to paint for them. Due to the suspicion of investors, Bernie Ebbers was forced to step down as CEO in 2002 (April) when it was found that he had taken a loan of $400 million from BoA (Bank of America) in 2000 to cover margin calls. Ebbers used his own shares in WorldCom as collateral for the loan. Therefore, with WorldCom's downfall, Bernie Ebbers lost his fortune as well.

1.1.1 Negligence of the Board of Directors

WorldCom had the board of directors consisting of 11 directors, eight of whom were independent. The board failed to fulfil its basic responsibilities. Acquisitions made by the company with the approval of the board, in many instances appeared to be opportunistic rather than part of the long-term strategic plan. The board's review of acquisitions was not comprehensive and the left the company highly levered. These strained the financial structure of the company and complicated the analysis of the financial performance measurement. The board neglected in every aspect of the monitoring and oversight over the executives. The board failed to act or ignored accounting irregularities besetting the company more than 12 months before the company collapsed ultimately.

1.1.2 Weakness in Control System

There were weaknesses in internal control as well external control system. From a review of WorldCom's financial reports and internal documents, it was divulged that the executives of the Company knew as early as in 2000 that inappropriate accounting treatment was performed on the financial reports. Internal auditors are a company's first line of defence against accounting errors which can be in the form of faulty classifications without any intention to mislead and accounting fraud i.e. false classifications done knowingly to defraud. It is unclear why it took more than a year for WorldCom's IA to find these misstatements especially if we look at the amount of costs that were capitalized, which was found to be approximately $750 million every quarter, and the impact on net income and company's assets. It appears that internal auditors of the company were more focused on operational issues rather than substantive financial and accounting issues.

1.1.3 Audit Committee

The audit committee of the company consisting of majority of independent directors failed to discharge its function of reviewing the company's financial statements and monitoring internal accounting control activities. However, it acted on the alert of whistle-blower Cooper but it was too late by then to save the company from eventual bankruptcy.

1.3. Andersen Worldwide (US)

In June 2002, Arthur Andersen got convicted on grounds of obstruction of justice since it was found that it had shredded documents related to its audit of Enron when the Enron scandal came to light. In fact, SEC was also accused by many people for an oversight commission who as "asleep at the wheel". Arthur Anderson was the collateral damage in the Enron scandal due to its role in hiding Enron's misdeeds. Once it was discovered that the firm was in cohorts with Enron, its other audits were also investigated and it was found that it had played a similar role in hiding fraud done by its clients. Some of the big names who collapsed because of investigation into Arthur Anderson were Waste Management, WorldCom, and, Sunbeam. Multiple reasons were recognised by experts for the downfall of Arthur Andersen.

1.1.1 Deficient Culture

The collapse of Arthur Andersen was inevitable. Audit failure at Boston Chicken, Enron and Waste Management were proof that the firm lacked in culture and leadership. Several partners who were charged with auditing these companies were found lacking in professionalism due to their inadequacy in performing and signing audit reports of these companies. They were in management's court all along and did not realize their professional commitments.

1.1.2 Conflict of Interest

There was a conflict of interest on many clients' accounts as Andersen was providing audit, accounting and consulting services simultaneously collecting a huge amount of fees from those assignments. For example, it received $52 million as audit fees from Enron for external and internal audit services. Providing non-audit service was denting the independence of the auditor.

1.1.3 Lack of Independence

The lack of independence of Andersen can be identified clearly if we look at the firm's relationship with Enron. The firm's employees had a permanent office space for themselves in Enron's office. Andersen's employees were a part of multiple events which were organized by Enron. A cosy relationship existed between Andersen and Enron, in particular made it easy to continue with improper accounting and audit practices.

1.1.4 Long Audit Tenure

Long audit tenures tend to develop a situation of over-familiarity with the clients. For example, Andersen was auditor of Enron for more than 20 years. This led to Andersen over-looking conflicting activities and deficiencies in the clients' internal control systems.

1.4. Satyam Computer Services Ltd. (India)

The Satyam Computer Services scandal came to the forefront in 2009 when the India based company's chairman Ramalinga Raju confessed to fabricating the company's accounts. On 7 January, 2009, Mr. Raju sent an email to SEBI and the stock exchanges where he disclosed that he had inflated the cash and bank balances of his company Satyam Computer Services. Ramalinga Raju did this by excluding certain receipts and payments from the financial books of the company. The overall misstatements discovered were of Rs 12,318 crore. This analysis was performed by SEBI. Approximately 7,561 fake bills were caught in the company's internal audit reports. Through use of just fake invoices, Raju was able to inflate the company revenue by Rs. 4,738 crore in just a span of 5 to 6 years. The investigation was performed in a course of around six years. The fraudulent invoices enabled Raju to show fake debtors on the company's financial reports up to Rs 500 crore. There were various flaws in the company's governance model.

1.1.1 Small Holding of the Promoters

The promoters of the company held a small percentage of shares in the company. They were only worried that poor performance of the company might lead to a takeover or divesting of their control over the company. The promoters especially Mr. Raju built up his clout in the company and outside by showing fabulous results and floating success stories. The numerous awards conferred on Mr. Raju placed him as the charismatic leader of the company. He had unquestioned control over the company.

1.1.2 Failure of the Board of Directors

The board of directors of Satyam had well acclaimed persons as the members. The board failed miserably in its prime duty of oversight. The fraud had sons as the members. The board of directors of the company composed of a majority of independent directors, remained either ignorant of the whole scam or turned a blind eye to wrong practices. At the behest of the promoters the board cleared the deal of acquiring family concerns of the promoters even though it was a major departure from the normal activities and expertise of Satyam. It was clearly a failure on the part of the board of directors of the company especially independent directors who cleared the deal ignoring the interest of the other (majority) shareholders.

1.1.3 Failure of the Audit Committee

The audit committee of Satyam failed in its duty to act on a whistle blower's expose. As per the investigations done by SFIO, on 18 December, 2008, the company's independent director Krishna Palepu had received an email by an alias Joseph Abraham. This was just two days before the company's board had met and agreed to acquire two firms Maytas Infra Ltd. and Maytas Properties Lt.d (group firms), which were led by the two sons of Mr Ramalinga Raju. The email was sent to expose the fraud in the company. The email was forwarded to M. Rammohan Rao, another independent director of the company and Chairman of the audit committee, by Krishna Palepu. M. Rammhona Rao further sent that email to the partner of their audit company PWC, S. Gopalakrishnan. S. Gopalakrishnan assured M. Rammohan Rao that there was no truth in the allegations stated in the email. He promised a detailed presentation to the company's audit committee on 29 December which was further deferred to January 10.

1.1.4 Non-disclosure of the Pledging of Promoters' Shares

Another questionable corporate governance practice in India is that of non-disclosure of pledging of shares by the promoters or controlling shareholders. Mr. Raju had pledged most of his promoters' stake to borrow funds. The lenders enforced the pledge following a decline in market price of shares of the company resulting in a decline in the shareholding held by Mr. Raju from 8.74 percent in March 2008 to merely 3.6 percent as on January 1, 2009. The stakeholders of the company had no clue about the depleting shareholding of the promoters in the absence of any disclosure.

CHAPTER 2

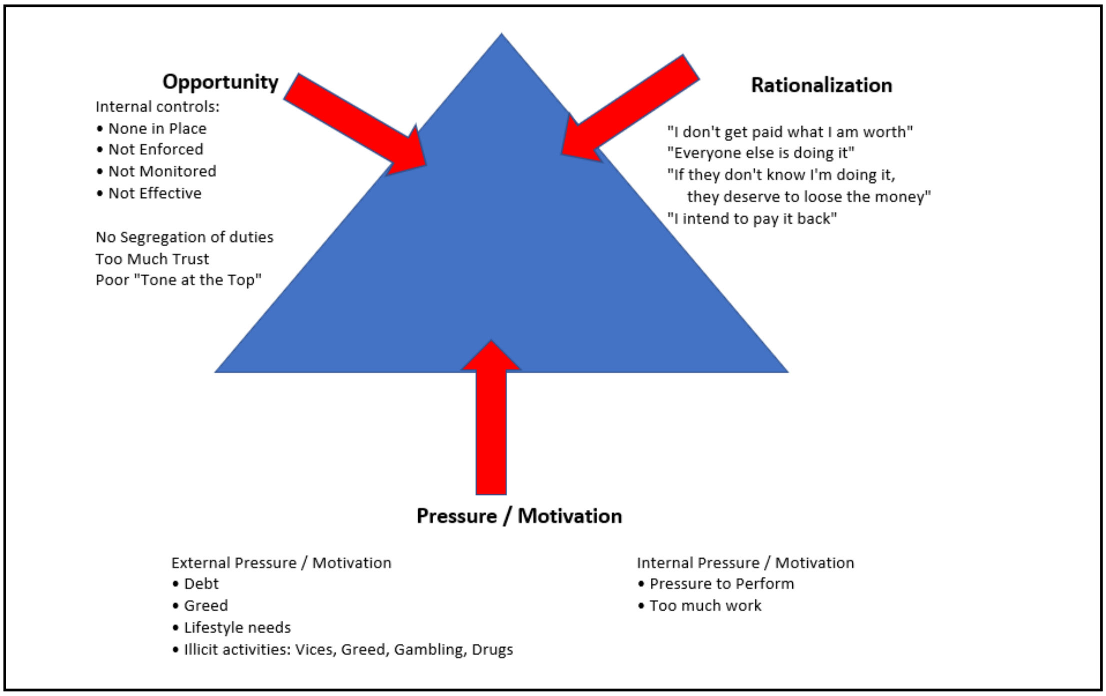
Governance Problems in Corporate Failures

2.1. Fraud Triangle

Fraud triangle framework is used in auditing to explain the motivation behind an individual's decision to commit fraud. The fraud triangle has three components that contribute to increasing the risk of fraud:

- Opportunity
- Incentive
- Rationalization

Figure 1: Fraud Triangle (Donald R. Cressey)



Fraud is a deception that is intentional and caused by an employee or organization for personal gain. i.e. to gain an advantage or generate an illegal profit.

2.1.1. <u>Opportunity</u>

Circumstances that allow fraud to occur are referred as opportunity. It is what a company exercises complete control over. For example, weak internal controls, poor leadership's tone i.e. upper management and its board of directors' dedication to be ethical, and honest, to ensure integrity and use inadequate accounting policies.

2.1.2. Incentive

Incentive or pressure, is an employee's psyche to commit fraud. Incentives can be in the form of bonuses or a financial metric such as revenue or net income which can create a situation of pressure for the individual to meet their targets. This might lead to employees committing fraud to achieve their objectives. Additionally, a personal incentive to earn more money can be one of the biggest incentives to commit fraud.

2.1.3. Rationalization

Rationalization is an individual's justification to commit fraud. For example, an individual who has bitter feelings for his employer might try to get payback from their employer by committing fraud. They may also believe that if management is already doing it then why not I. Another way of rationalization can be thinking that there is no other solution except fraud.

2.2. Failure of Board of Directors

This is the most common governance failure model in various corporate failures discussed in this paper. The failure of boards in corporate collapses have been identified to occur for the following reasons:

- Lack of Independence or Conflict of Interest
- Unwillingness of the Board to challenge the dominating CEO
- Lack of strength of the board
- Combination of the Role of Board Chairman and CEO
- Insufficient Skills of the Directors

2.3. Failure of Corporate Strategies

The prime obligation of the board is to figure out corporate procedures which are in the best interest of all stakeholders, including shareholders. The boards of the failed companies had blundered in formulating strategies and policies in the interest of the companies. In most of the cases, the systems were not satisfactory being founded on impulses and likes of the founders or over dominating CEOs in complete negligence to the rights of the shareholders. The approaches were centred too much around the momentary benefits and offer costs. The procedures were not in consonance with the assets and capacity of the organization which led to excessive risk taking which could not be controlled and ultimately led to the collapse.

2.4. Failure of Internal Controls

Internal controls systems within an organisation provides balanced governance to guarantee lawful prerequisites to prevent frauds and to ensure governance in the interest of stakeholders. Breakdown in internal controls and frameworks made the organizations defenceless pressures and problems which eventually led to their collapsed. Internal auditors are the first line of defence against accounting errors and fraud. Failure by internal auditors to identify material weaknesses have been one of the reasons of the past scams we have witnessed.

2.5. Failure in External Audit

The corporate failures which have happened within the past one after the opposite question the utility and efficacy of the external audit process. In the majority such cases, either the auditors applied faulty audit techniques or were negligent in performing their duties or had the conflict of interest.

2.6. Inadequate Regulatory Mechanisms

Regulatory framework is designed to strengthen corporate governance by requiring compliance with the rules and regulations. Weakening of the regulatory mechanism which may arise from oversight of the regulators or poor implementation of the rules or lax rules or conflict of interest can compound corporate governance problems and speed up the collapses. This happened in BCCI, Enron WorldCom, Pamalat, Tyco etc. The regulators could not detect the faulty accounting techniques and valuation methods being adopted by the failed companies. The lenders also failed to monitor their borrowers and relied on forged documents especially in case of Parmalat. In most of the cases, lenders failed to keep the leverage of their borrowers within manageable limits. The disclosure requirements in most of the cases of corporate failures was found to be inadequate, e.g. in Satyam, promoters were off-loading the pledged shares without being any disclosure.

CHAPTER 3

Corporate Governance Evolution

3.1. Evolution of Corporate Governance Framework in India

Corporate governance came into importance after 1980s and especially after Cadbury advisory group issued the code of corporate administration. “Corporate governance” was mentioned in the advisory group’s report named Financial Aspects of Corporate Governance, 1992 as “the framework by which organisations are coordinated and controlled”.

A code of corporate administration was issued by the Kumar Mangalam Birla Committee for organisations in India which was in line with the Cadbury Council.

3.1.1. Before 1980s – Evolution of Legal framework

The Companies Act was enacted in 1866 and consequently amendments were made to it. The amendments were made in 1882, 1913 and 1932. Partnership Act was enacted in 1932. The act had provisions to ensure that people or businesses who went into contract with other businesses. It was found that during this time resources were misused and management of firms ignore their obligations and duties. The reason was this conduct was identified to be scattered and unprofessional ownership of firms. Proprietorship was more prevalent in that time period.

After 1945, i.e. after independence in India, with the there was a rapid growth in production of essential items. The Government had the power to decide fair prices of all essential products. Tariff Commission and the Bureau of Industrial Costs and Prices was setup for this reason by the Indian Government. Consequently in 1950, Companies Act and Industries Act i.e. for Development and regulation of Industries, were implemented by GOI. By 1960s, heavy industries had started to grow in India. The period between 1970s to mid-1980s was a time of cost, volume and profit examination, as a vital piece of the cost accounting activities.

Endeavours were made by firms in India to put the frameworks of good corporate administration, whether or not any regulations were in place. However, since the business environment was promoter-centric therefore, governance norms were foregone for convenience or comfort of the promoters.

For this reason, the fundamental code for corporate administration was proposed by the Chamber of Indian Industries (CII) in 1998. The proposal by CII was—corporate governance manages laws, methods, practices and understood principles that decide an organisation's capacity to take administrative choices—specifically its investors, banks, clients, the State and the representatives.

3.1.2. Post 1990s – Reformations in Corporate Governance

The first phase of reforms for Corporate Governance in India started by making Audit Committees and Boards more independent, focussed and powerful supervisor of management. They also focussed on of aiding shareholders, including institutional and foreign shareholders/investors, in supervising management. These reform efforts were implemented with support of both the Ministry of Corporate Affairs (MCA) and the Securities and Exchange Board of India (SEBI).

In 1996, CII took up the first institutional initiative in the Indian industry on corporate governance. CII's aim was to promote and develop a code of governance for companies, irrespective of their sectors, public or private, financial institutions or banks, i.e. to span all the corporate entities. CII's measures were to address public concerns regarding the security of the interest and concern of investors, especially the small investors; encouragement of transparency within industry and business, the necessity to proceed towards international standards of disclosure of information by corporate bodies, and build a high level of people's confidence in business and industry. In April 1998, the final draft of this Code was launched.

Kumar Mangalam Birla Committee's report was the second influencer of the reforms introduced during the time. Mr Kumar Mangalam Birla was engaged by SEBI to give a thorough and in-depth view of the issues related to insider trading. This was done by SEBI to come up with ways so that rights of investors could be secured. The Committee held that there was a need for listed companies to give disclosures in a phased manner in a given period of time. This was done to ensure that investors had knowledge of how companies were utilizing their funds, projects that were being undertaken by the companies. This was to be done so that companies would have a robust corporate governance framework.

The significance of an auditing body was identified by Mr. Birla's committee. Additionally, suggestions were also made for the composition and functions of Board of Audit Committees within the firms. SEBI accepted these suggestions and introduced them as rules and regulations for the companies in phases from 2000 to 2003. These rules were listed in Clause 49 of the listing agreement as a new section.

In March of 2001, another advisory group, Standing Committee on International Financial Standards and Code, compared the corporate governance rules and regulations in India with the International Standards to give suggestions for improvement of the standards in India.

A Consultative Group of Directors of Banks, with RBI as its member, was tasked with reviewing the authoritative role of FIs and boards of banks. This was done to understand the board's measures related to compliance, disclosures, audit committees, etc. Suggestions were then provided to the Board of directors of these banks and FIs so that they could be more effective in performing their oversight responsibilities and reduce and mitigate the risks.

Another report of the Naresh Chandra Committee on Corporate Audit and Governance Committee came in December, 2002. The committee was tasked with analysing and providing suggestions in different areas like—the company and statuary auditor relationship, procedure for appointment of Auditors, fixing of audit fee, restrictions, if required on non-auditory fee, measures to ensure that management and companies put forth a true and fair statement of financials of the company.

A SEBI's report to improve corporate governance standards on Corporate Governance which was issued with N.R. Narayan Murthy's assistance in February 2003. The report performed studies on the role of independent directors, risk management in an organisation, directors and their compensation, codes of conduct in a company and the financial disclosures a company might provide in its financial reports.

Naresh Chandra Committee II was setup in January 2003 to give a report on Regulation of Private Companies and Partnerships. With the increase in numbers of private sector companies there was a need to revisit the law again. Focus was on Companies Act, 1956 and Partnership Act, 1932. In 2004, SEBI introduced changes in Clause 49 based on recommendations from the Murthy Committee. The recommendations were not implemented till 2006 because it was believed that the industry was not prepared for them and therefore gained resistance in implementation. Governance requirements for corporate boards, CFO/CEO certification of internal controls, audit committees, and shareholder disclosure for media were a huge part of evolution of the governance and disclosure standards in India.

3.2. Satyam Scam's Impact on CG

India's experienced one of the biggest scandals in its history in January 2009 when fraud in the financials of Satyam and the failure of its board was revealed. The Satyam scandal was a catalyst for the Indian Government to revisit the existing corporate governance, accountability, disclosure and enforcement mechanisms in place. Shortly after news of the scandal broke, CII began its inspection of the corporate governance issues brought to light due the Satyam scandal. Industry groups started forming corporate governance and Ethics Committees to study the impact and lessons of the scandal. In late 2009, reform recommendations for Corporate governance were put forth by the CII task force.

CII emphasised the unique nature of the Satyam scandal in its report, observing that Satyam was a one-off incident. The majority of corporate India was well run, was well regulated and was doing business in a legal and sound manner. Additionally, the National Association of Software and Services Companies (NASSCOM, trade body and the Chamber of Commerce of the IT-BPO industries in India) also formed a Corporate Governance and Ethics Committee, chaired by N.R. Narayana Murthy, one of the founders of Infosys.

3.3. Corporate Governance – Legal Framework

- The Companies Act, 2013: This act consists of law provisions inclusive of, but not limited to, for composition of the board, aim and frequency of board meetings, business processes, the role and appointment of independent directors, Annual general meetings, a firm's audit committees and disclosure requirements in financials reported by the company.
- Standard Listing Agreement of Stock Exchanges: The companies with shares listed on Indian stock are required to have this agreement.
- Auditing and Accounting Standards Issued ICAI: ICAI is an independent body called Institute of Chartered Accountants of India. It has the responsibility to issue accounting and auditing standards. Based on the Sec. 129 of new Companies act, 2013, it is a mandate for firms to ensure that their financial statements are a fair representation of their affairs and are in accordance with the auditing standards mentioned within Section 133 of the act. Additionally, companies are liable to ensure that the information in their financial statements are in accordance with the accounting standards.

- SEBI Guidelines: Securities Exchange Board of India is the governing authority in India. It has jurisdiction and power over listed companies in India and is tasked with issuing rules, regulations and guidelines to companies to ensure the protection of investors.
- Institute of Company Secretaries of India issued Secretarial Standards (ICSI): The secretarial standards by ICSI are within the provisions of Companies Act, 2013. It is a professional statutory body in India. Its main objectives are to of promote, regulate and develop the profession of company secretaries in India.

In the years since the scams like Satyam broke out, we have witnessed substantial changes with regards to corporate governance in India. The regulators and investigative bodies have become more observant. The companies have to pay heavy penalties in case they are found to be non-compliant. All these measures have benefited and secured interests of shareholders and stakeholders of a company.

3.4. Changes in Audits

With the ever-changing corporate governance environment and the various scams which have come to light in the past years, there is an increased awareness and respect for the various facets of corporate risk among companies and boards. Companies are investing in technologies like RPA and AI to automate and digitise their business processes and to reinforce their preventive and detective internal controls against frauds. Company Boards have begun linking the compensation and incentives of top executives their management with strategic goals.

Audit committees and Board of companies have more power of oversight now. Since April 2017, regulations were issued where audit firms who are external auditors to a company have to be rotated every 10 years. Even auditors do not remain unaffected from the intense scrutiny of regulatory bodies. Auditors must confirm that company which they are auditing has effective internal controls over financial reporting. This has been prescribed under the Companies Act, 2013.

Even after having witness of scams like Satyam in India, companies are more concerned about ticking the boxes in their audits. India would need to do a lot more to strengthen its corporate governance framework for companies to come at par with mature markets like US. The main obstacle in the corporate governance evolution of India is that most of the Indian companies are still controlled and managed by their promoters. The independence of Directors is only on paper. They are either someone from the family of the promoter or close friends and acquaintances. The Companies Act has huge consequences if role of Director is not taken seriously by the independent Directors. The Companies Act has defined roles and responsibilities of a Director very clearly. It is because of these stringent rules that professional individuals or prospective Directors are collaborating with consultancies to obtain guidance and training for their roles. The Satyam scam also played a huge role in bringing about changes in the auditing practices in India. For example, in Satyam's case its auditor PwC was also convicted along with the firm's owner Raju Ramalinga. Major audit firms are now taking lessons from such incidents and are performing a risk assessment of the client before accepting the client for audit. Firms are also moving away from manual audit procedures and are now venturing into areas of data analytics and machine learning to identify "unusual patterns" or indications of fraud in the client's financials. Auditors are continuously performing a review of their own procedures on past audits to identify gaps and ensure that their procedures evolve with their client's business. An example of mistakes made by PwC in Satyam's audit was the reliance they put on bank statements of up to Rs 3,800 crore furnished and fabricated by the culprits in the scam. Now as per the new regulations, it is a mandate for auditors to check for authenticity, completeness and accuracy information provided by entity including bank statements. Ramalinga Raju had also hidden the fact that he had pledged his shares in the company. As per the new regulation, pledging of shares by promoters is required to be disclosed to SEBI.

Internal Controls over Financials has also heled in improving oversight. Auditors are responsible to report whether a company has a sufficient internal financial controls system in place over its financials and if they are designed and operating effectively. Companies are also moving more towards technology to reduce manual i.e. human intervention in reporting to decrease the risk of fraud.

The Companies Act, especially the standards around of IFC i.e. Internal Financial Controls and disclosures of related party transactions ensures that interests of shareholders are safeguarded.

CHAPTER 4

COVID-19 Impact on Corporate Governance

4.1. Changes in Corporate Governance

Due to the crisis the world is in right now (2019), we can expect to see changes in the way companies address the following areas in their governance framework:

- Changes in CSR framework of organisations
- Digitalization of Corporate governance
- Role of institutional investors and stewardship
- M&A trends and Takeover defences
- Bankruptcy and Bond markets
- Corporate Purpose in these unprecedented crisis
- Governance implications of government bailouts and emergency laws
- Changes in Securities regulation (short-selling bans, disclosure)
- Environment, Social and Governance and Impact investing
- Financial stability and Systemic risk due to exogenous shocks

4.2. Threats to Corporate Governance

As discussed earlier, there are three motivations to commit fraud are Opportunity, Incentive and Rationalization. With the current COVID situation, companies have all three motivations. With the increasing number of pay cuts at Executive level and threats of job loss to employees, there is an increased threat of rationalization. It is up to organisations to consistently monitor their environment to ensure that they are not exposing themselves to such threats. Additionally, with less oversight and increased relaxations by regulatory bodies there is an increase in opportunity and incentives for organisations. Therefore, the companies should ensure their lines of defence are equipped to handle the risks due to these unprecedented times.

4.3. Regulatory Response

It has been observed globally that regulatory framework has changed due the COVID-19 pandemic. Regulators (FED, ECB, EBA, FCA, etc.) are providing guidance and targeted regulatory relief to ease the pressure on financial institutions from capital, liquidity, regulatory reporting and other prudential requirements. They continue to insist on core compliance and to clampdown on activity that could be seen as not supporting the societal effort. Reserve Bank of India announced a range of measures including a 75bps repo rate reduction, 3-month forbearance on all term loans, open market operations, and reduction in reserve requirements. Additionally, RBI created a Rs 500 billion (US $6.6 billion) emergency fund to help fund hours contain a looming liquidity crisis, following the collapse of six of Franklin Templeton Mutual Fund’s debt strategies. Ministry of Corporate Affairs, India, announced that the Government of India has setup the Prime Minister’s Citizen Assistance and Relief in Emergency Situations Fund to deal with any kind of emergency or distress situation. MCA has announced it has decided to relax the compliance burden of companies in India following the rising cases of COVID-19 in India. MCA has also allowed board meetings to be held through video conferencing or other audio visual means up till 30 June, 2020.SEBI issued a circular providing temporary relaxation until 30 June, 2020 with respect to KYC compliance requirements for Foreign Portfolio Investors (FPIs).Most regulatory tax filings which were due on 31st March 2020 was extended to 30th June 2020 (Income Tax, GST, Stamp duty payments, Due date of filing Income tax returns, customs etc.) and relaxed penalty rates were introduced. With these relaxations from regulators, companies might have some relief in this crisis however, it is imperative for regulators and auditors to ensure such measures are not exploited by organisations.

1.5. Research Methodology

A qualitative secondary research was performed to gain insights into various ways and methods which were used by Companies which were identified with the biggest Corporate Governance failures in the world. The secondary research enabled us to identify factors responsible for corporate governance failures and the means utilized for fraud. Based on the factors identified we performed a qualitative interview of C-Suite of top 8 companies in varying industries in the world to identify their preparedness in upgrading their Corporate Governance framework in the COVID-19 pandemic era.

4.4. Questions for Auditing Clients to identify red flags in Corporate Governance during COVID-19 Era

Based on the corporate governance environment and risks discussed above, auditors need to ask the following questions of their clients to ensure that the board and management is taking measures to prevent fraud or issues within their corporate governance environment. This will also enable auditors in identifying red flags early on. An interview of 8 C-Suite personnel was conducted to study the changes in Corporate Governance Framework in the organisations.

1. Do you have a remote operating model capable of being scaled up as things progress?
2. Are there changes required to the governance and decision-making process if there is a need for a prolonged period of remote working or a partial shutdown?
3. Are there clear protocols in place for when department heads, Divisional CEOs, ExCo or Main Board members become sick?
4. What is the CCOs role in the fast-moving decision environment and new rules under which firms are operating to deliver stimulus, be seen as fair to customers, act with integrity in markets and maintain appropriate controls?
5. How can CCOs obtain the information needed to effectively respond to the pandemic and its impacts on their function?
6. How can CCOs effectively communicate issues, plans and responses to key stakeholders and their evolving needs?

7. How CCOs can oversee and support the roll out of the business continuity plans?
8. How CCOs can keep the right level of attention in respecting rules in relation to the financial institution customers and avoid potential fraudulent actions (market abuse, MiFID and IDD, financial crime, frauds, etc.)?
9. How can companies maintain trust with employees, investors, creditors and other key stakeholders?
10. How CCOs can support the financial communities to rise potential concern and suggest future focus of Authorities and Regulators?
11. Are there any major changes in terms of layoffs/furloughs or pay cuts in Executive Compensations?
12. Have you tested IT infrastructure resilience for increased levels of remote working and increased use of digital services?
13. Are you pro-actively testing the capacity of IT infrastructure against the risk if increased cyber-attacks
14. Are you able to screen and monitor increased risks of cyber-related fraud and increased using of tactics such as phishing?
15. Market disclosure – Is there a process for assessing and disclosing relevant significant information concerning the impacts of COVID-19 on fundamentals, prospects or financial situation in accordance with Market Abuse Regulation?
16. Financial Reporting- Is there a process to the extent possible for a qualitative and quantitative assessment on business activities, financial situation and economic performance of 2019 year-end financial reporting if these have not yet been finalised or otherwise in their interim financial reporting disclosures
17. Are you clear how you will be able to best tap the Finance and Liquidity schemes?
18. Have you translated what the removal of the Counter Cyclical Buffer means for you in terms of RWA headroom and what that means for priority areas / risk appetite?
19. Have you understood the earnings impact of the interest rate reduction across your business?

20. Have you modelled the interplay of all the above, with new lending volumes and potential losses therein to have a confident view around incremental credit extension?
21. Do you have a dynamic review of impacted locations and impacted industries?
22. Have you modelled credit losses under different downturn scenarios?
23. Are your risk models / actuarial models capable of taking pandemic scenarios?
24. If so, how have you used them, how are you calibrating them?
25. Do you have a watchlist of affected clients?
26. Have you amended credit criteria for new originations and for forbearance?
27. How do you plan to tell an iterative story from a financial impacts stand-point – considering both P&L and B/S impacts?

Answers to the above questions will help auditors gauge how prepared the companies are to tackle the COVID-19 pandemic situation and if they are susceptible to risks of fraud or corporate governance issues.

4.5. Conclusion

Based on the interviews conducted, we were able to conclude that 75% of the organisations were prepared for remote operations. 95% organisations indicated they had planned for Executive pay-cuts and furloughs of its employees. The board charged with oversight responsibilities was actively monitoring the companies in all cases. The companies had started leveraging technology at their disposal to support remote operations. New technology implementations were observed for 70% of the companies interviewed however, the remaining had deferred new projects or technology implementations in consideration of the COVID-19 pandemic situation. Additionally, it was observed that C-Suite of these top organisations were well prepared to handle this crisis situation and had started preparations to ensure their financial reporting is not impacted due to the current situation.

4.6. Suggestions for the Board

For companies all over the world, including Indian public companies, COVID-19 has created unique and extreme challenges. Addressing the COVID-19 crisis requires careful consideration by the board under these circumstances.

As part of director oversight responsibilities for good corporate governance, the board can take following steps in response to COVID-19 include the following:

- Enhancements to the company’s existing report and information systems which are employed by the board for oversight. This is to ensure that the board receives important information in to time to observe and detect COV-19 issues and the risks related to them. The board of companies need to adopt a proactive approach rather than a reactive approach so that material risks due to COVID-19 pandemic can be red-flagged early on before they materialize.
- Board can form an evaluation committee, who will continuously monitor and evaluate the business risks and as required can ensure that appropriate preventive and detective measures are put in place to safeguard company’s operations and affairs against the impact of COVID-19. Regular meetings should be scheduled by the committee and detailed meeting minutes should be maintained as evidence.
- There should be an open dialogue between board and the management to ensure measures required to be take in order to ensure health and safety of the employees. Both need to ensure that the legal developments at centre and state level are reviewed and are in accordance with the company’s policies. If required, immediate adjustments should be made as per the changes in the regulations.
- Evaluating potential disruptions in relationships with stakeholders or disruptions to operations and business relationships. This would include but is not limited to impact of the pandemic on customers, sources of finance, suppliers, service providers etc. Inspections of

contractors with service providers should be done to identify potential risks of disruption in services due to the ongoing situation.

- Companies can also consider deferring incentives and bonuses for executives and can assess the current situation to identify and set targets and goals for them.

4.7. Limitations of the Study and Future Scope

C-Suite of Clients from varying industries were interviewed for the questions mentioned in this paper. However, due to client privileges the results cannot be shared. Additionally, the impact of COVID-19 and the differences in Corporate Governance, Legal and Regulatory framework are different across the world which may influence the responses in our study. The study can be extended to auditors as well to assess their level of professional scepticism and their audit approach in consideration with the various corporate governance failures the world has witnessed. The study is qualitative in nature and can be expanded to include qualitative analysis of professional scepticism of auditors in the COVID-19 pandemic era.

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