Corporate Governance

1. Introduction

Corporate Governance refers to the way a corporation is governed. It is the technique by which companies are directed and managed. It means carrying the business as per the stakeholders' desires. It is actually conducted by the board of Directors and the concerned committees for the company's stakeholder's benefit. It is all about balancing individual and societal goals, as well as, economic and social goals.

Corporate Governance deals with the manner the providers of finance guarantee themselves of getting a fair return on their investment. Corporate Governance clearly distinguishes between the owners and the managers. The managers are the deciding authority. In modern corporations, the functions/ tasks of owners and managers should be clearly defined, rather, harmonizing.

Corporate Governance deals with determining ways to take effective strategic decisions. It gives ultimate authority and complete responsibility to the Board of Directors. In today's market-oriented economy, the need for corporate governance arises. Also, efficiency as well as globalization are significant factors urging corporate governance. Corporate Governance is essential to develop added value to the stakeholders.

Corporate Governance ensures transparency which ensures strong and balanced economic development. This also ensures that the interests of all shareholders (majority as well as minority shareholders) are safeguarded. It ensures that all shareholders fully exercise their rights and that the organization fully recognizes their rights.

Definitions of Corporate Governance

1. The definition of corporate governance most widely used is "the system by which companies are directed and controlled" (Cadbury Committee, 1992). More specifically it is the framework by which the various stakeholder interests are balanced, or, as the IFC states, "the relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders".

2. The OECD Principles of Corporate Governance states:-*"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."*.

Benefits of Corporate Governance

1. Good corporate governance ensures corporate success and economic growth.

2. Strong corporate governance maintains investors' confidence, as a result of which, company can raise capital efficiently and effectively.
3. It lowers the capital cost.
4. There is a positive impact on the share price.
5. It provides proper inducement to the owners as well as managers to achieve objectives that are in interests of the shareholders and the organization.
6. Good corporate governance also minimizes wastages, corruption, risks and mismanagement.
7. It helps in brand formation and development.
8. It ensures organization in managed in a manner that fits the best interests of all.

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Principles of corporate governance

- **Rights and equitable treatment of shareholders**:[13][14][15] Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by openly and effectively communicating information and by encouraging shareholders to participate in general meetings.
- **Interests of other stakeholders**:[16] Organizations should recognize that they have legal, contractual, social, and market driven obligations to non-shareholder stakeholders, including employees, investors, creditors, suppliers, local communities, customers, and policy makers.
- **Role and responsibilities of the board**:[17][18] The board needs sufficient relevant skills and understanding to review and challenge management performance. It also needs adequate size and appropriate levels of independence and commitment
- **Integrity and ethical behavior**:[19][20] Integrity should be a fundamental requirement in choosing corporate officers and board members. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.
- **Disclosure and transparency**:[21][22] Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide stakeholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

India

India's SEBI Committee on Corporate Governance defines corporate governance as the "acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal & corporate funds in the management of a company."[25] It has been suggested that the Indian approach is drawn from the Gandhian principle of trusteeship and the Directive Principles

of the Indian Constitution, but this conceptualization of corporate objectives is also prevalent in Anglo-American and most other jurisdictions.

[edit] Codes and guidelines

Corporate governance principles and codes have been developed in different countries and issued from stock exchanges, corporations, institutional investors, or associations (institutes) of directors and managers with the support of governments and international organizations. As a rule, compliance with these governance recommendations is not mandated by law, although the codes linked to stock exchange listing requirements may have a coercive effect. For example, companies quoted on the London, Toronto and Australian Stock Exchanges formally need not follow the recommendations of their respective codes. However, they must disclose whether they follow the recommendations in those documents and, where not, they should provide explanations concerning divergent practices. Such disclosure requirements exert a significant pressure on listed companies for compliance.[*citation needed*]

Auditors examine company’s accounts and report to the company on the accounts. Fundamentally, the concern is how auditors carry out these duties effectively. Legislations namely Companies Act 1965, Securities Industry Act 1983 which has been consolidated as Capital Market and Services Act 2007 have made major inroads to ensure that auditors carry out their duties and obligations effectively. Additionally, the Code of Corporate Governance was drawn in 2001 and amended in 2007, to further enhance the effectiveness of audit in the interests of stockholders and stakeholders. Nonetheless, it is pertinent to determine whether the Code of Corporate Governance is adequate and comprehensive in ensuring that auditors play effective role in auditing a company. This is particularly imperative in the light of recent scandals involving auditors in Malaysia and in other parts of the world. The study then proceeds to explore the appropriate litmus test in laying down sound principles governing the duties and obligations of auditors. This is crucial because there is increased reliance by the stockholders and stakeholders on auditors. Moreover, there is a growing concern for corporate governance domestically, regionally and globally. Thus, a comparative study is also carried out as to how the issue of corporate governance is addressed in other parts of the world. Finally, the study shows that the Malaysian Code of Corporate Governance governing the duties and obligations of the auditors has not produced the desired result pertaining to accountability.

AUDITING — ROLE OF AUDITORS IN GOOD GOVERNANCE: Auditing is defined as obtaining and evaluating evidences regarding assertions about economic actions and events to ascertain the extent to which they correspond with the established criteria, and to communicating the result to the interested users. Thus, it encompasses investigation process, attestation process, and the reporting process, pertaining to economic actions and events.

International Audit Standards maintain that an auditor's mandate may require him to take cognizance and report matters that come to his knowledge in performing his audit duties which relate to:

>Compliance with legislative or regulatory requirements;

>Adequacy of accounting and control systems;

>Viability of econonuc activities, programmes, and projects.

Two variant situations emerge when the functions of auditors and the requirements of good governance are placed face to face. The former is confined to 'econonuc actions and events, while the later is the outcome of a wide range of managerial functions. The question then arises whether the auditors should cross their operational limits in order to bring about the desired level of improvement in the quality of governance, or, alternatively, while restricting themselves to their term of reference, they should operate more effectively so as to help improve the quality of governance.

Lately, a view has emerged that auditors should play a more vital and direct role in establishing good governance. Should this mean to expect them to cross the established borders of genuine audit functions, it would be stretching the string too far, without gaining any thing positive and substantial. The only alternative then is to make the auditors feel more conscientious, more dutiful, and therefore to be more effective, while restricting themselves to their term of reference.

International Auditing Standards (IAS) also recognize that the matters that may be relevant to the governance of any business entity may be broader than those that form the subject matter of IAS, which are directly related to the audit of financial statements. IAS 260 categorically requires the auditors to communicate with the officials charged with the governance of an entity the matters arising from the audit of financial statements. They will not be required, the IAS continues, "to design procedure for the specific purpose of identifying matters of governance interest".

Even the Code of Good Corporate Governance envisaged by the SECP subscribes to this phenomenon. Rather, it prohibits in explicit terms any such excesses on the part of the auditors. Paragraph xl under the heading 'External Auditors' reads:

"No listed company shall appoint its auditors to provide services in addition to audit except in accordance with the regulations and shall require the auditors to observe applicable IFAC (International Federation of Accountants) guidelines in this regard and shall ensure that the auditors do not perform management functions or make management decisions, responsibility for which remains with the Board of directors and management of the listed company. "

Thus, it is established that auditors are not required to traverse their area of operation. Whatever they are expected to contribute towards good governance shall, therefore, be from within their range or sphere of activity. In other words, it is the quality of their performance that will make all the difference, which, therefore, needs to be ameliorated to match the requisites of good governance.

Once it is settled that it is the quality of audit that is aimed at, the question arises what is the desirable quality, and how can it be measured? The question has gained great momentum in recent years when considerable attention has been focused on the auditor's responsibility for negligence. This is largely the result of wide publicity being given world over to considerable sums sought by plaintiffs in compensation for losses they have suffered, losses which, they believe, could have been prevented had the auditors been more vigilant. To quote a lively example, m/s Pricewater House, auditors of BCCI, remained in the news for quite some time during the last decade of the preceding century for their reportedly inapt behaviour leading to the collapse of the Bank.

An answer to this very pertinent question can be traced back in what Denning LJ observed in Candler v. Crane Christmas & Co. (1951), whose opinion was later upheld in famous Hedley Byrne case [Hedley Byrne & Co. v. Heller and Partners Ltd. (1963)], and which reads. " Their [the auditors'] duty is not merely a duty to use care in their reports. They have also duty to use care in their work which results in their reports".

The 'care' again is a relative term. The degree of care required may also vary from situation to situation. However, the overriding requirement is to have a "true and fair view".

Interestingly enough, what is 'true and fair' is not necessarily the 'truth'. The famous Elephant Story will help explain this riddle. Three blind men were led to an elephant and asked to state by touching it what it was. The first who touched the animal from the side and felt hard and broad span of the skin said it was a wall. The other who groped around the tail announced that it was a rope. The third gentleman who came in contact with the trunk claimed that it was a hose-pipe. All the three, to the best of their knowledge, were 'true and fair' but none of them was right. This leads to the conclusion that the perception and belief a person may have, and the opinion that he forms, about a set of circumstances depend upon: (i) his view point, and (ii) the information made available to him.

This becomes all the more important in view of the fact that the law has not defined the expression 'true and fair'.

Moreover, the whole process of auditing requires much imagination and careful thought from beginning to end. It is highly demanding and is often described as a very onerous responsibility. No doubt the vast majority of the profession do behave with integrity but auditors can and do some times fail to exercise their duty to as high a standard as is expected of them.

CONCLUDING REMARKS: This whole discussion leads to the conclusions that:

>The auditors should restrict themselves to their Magna Carta;

>Professionally, they should strictly abide by the Accounting Principles / International Accounting Standards.

>Morally, they should comply with the International Federation of Accountants' (IFAC's) Guidelines on Code of Ethics, as adopted by the Institute of Chartered Accountants of Pakistan.

With this discipline followed meticulously, the auditors' role would have overriding impact on the overall performance of an organization, thereby contributing substantially and meaningfully towards "establishing a framework of good corporate governance", the objective underlying the Code of Corporate Governance envisaged by the Securities and Exchange Commission of Pakistan.

Roles of the board of directors

The roles of the board of directors include :-

Establish vision, mission and values

Determine the company's vision and mission to guide and set the pace for its current operations and future development.

Determine the values to be promoted throughout the company.

Determine and review company goals.

Determine company policies

Set strategy and structure

Review and evaluate present and future opportunities, threats and risks in the external environment and current and future strengths, weaknesses and risks relating to the company.

Determine strategic options, select those to be pursued, and decide the means to implement and support them.

Determine the business strategies and plans that underpin the corporate strategy.

Ensure that the company's organisational structure and capability are appropriate for implementing the chosen strategies.

Delegate to management

Delegate authority to management, and monitor and evaluate the implementation of policies, strategies and business plans.

Determine monitoring criteria to be used by the board.

Ensure that internal controls are effective.

Communicate with senior management.

Exercise accountability to shareholders and be responsible to relevant stakeholders

Ensure that communications both to and from shareholders and relevant stakeholders are effective.

Understand and take into account the interests of shareholders and relevant stakeholders.

Monitor relations with shareholders and relevant stakeholders by gathering and evaluation of appropriate information.

Promote the goodwill and support of shareholders and relevant stakeholders.

A board of directors is a body of elected or appointed members who jointly oversee the activities of a company or organization. Other names include board of governors, board of managers, board of regents, board of trustees, and board of visitors. It is often simply referred to as "the board".

A board's activities are determined by the powers, duties, and responsibilities delegated to it or conferred on it by an authority outside itself. These matters are typically detailed in the organization's bylaws. The bylaws commonly also specify the number of members of the board, how they are to be chosen, and when they are to meet.

In an organization with voting members, e.g., a professional society, the board acts on behalf of, and is subordinate to, the organization's full assembly, which usually chooses the members of the board. In a stock corporation, the board is elected by the stockholders and is the highest authority in the management of the corporation. In a non-stock corporation with no general voting membership, e.g., a university, the board is the supreme governing body of the institution;[1] its members are sometimes chosen by the board itself.[2][3]

Typical duties of boards of directors include:[4][5]

governing the organization by establishing broad policies and objectives;

selecting, appointing, supporting and reviewing the performance of the chief executive;

ensuring the availability of adequate financial resources;

approving annual budgets;

accounting to the stakeholders for the organization's performance;

setting the salaries and compensation of company management.

The legal responsibilities of boards and board members vary with the nature of the organization, and with the jurisdiction within which it operates. For public corporations,[clarification needed] these responsibilities are typically much more rigorous and complex than for those of other types.

Typically the board chooses one of its members to be the chairman, who holds whatever title is specified in the bylaws.

role of shareholders

TP encourages shareholders to play an active role in the Company's corporate governance. Indeed, shareholder consent is required for key decisions, including: the review and approval of the financial statements and Management Board Report on Activities; the review and approval of the Management Board's recommendations on dividend payments; the review and approval of the Supervisory Board Assessment of the Group's situation; the election of the members of the Supervisory Board (and, if necessary, their dismissal); amendments to the Company's Articles of Association; increase and reduction of the share capital; and the buy-back of shares. At the Company's General Meetings, each share in TP entitles its owner to one vote. Holders of the Company's GDRs are also encouraged to submit their voting instructions to the Company's Depository Bank. In addition to their participation in General Meetings, members of the Company's Management Board and senior executives engage in active dialogue with the Company's shareholders. To ensure that investors receive a balanced view of the Company's performance, Management Board members – led by the President of the Management Board and the Chief Financial Officer – also make regular presentations to institutional investors and representatives of the domestic and international financial community