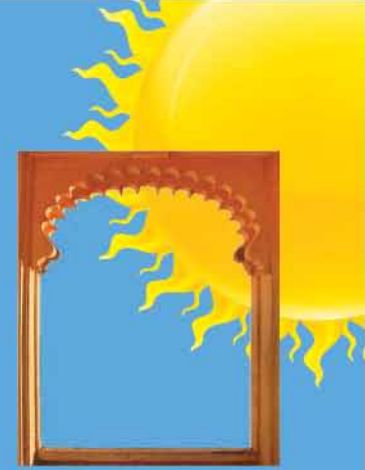


Board and Audit Committee Meetings under Regulations – Compliance in Letter or Compliance in Spirit?

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Executive Summary

- An analysis of board and audit committee meeting dates using a sample of top 500 listed companies for 2006-2012 shows that while most companies complied with the regulations of erstwhile Clause 49 relating to the number and interval between meetings, a significant percentage of the companies held most of their board and audit committee meetings on the same day with this percentage increasing remarkably over the years.
- The incidence of same-day meetings does not correlate with the potential drivers of such meetings and same-day meetings do not lead to higher attendance of outside directors.
- The empirical analysis suggests that while ‘compliance in letter’ is high, ‘compliance in spirit’ could be low.

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I. Introduction

The board of directors and the audit committee are two important internal mechanisms for promoting good governance in companies. One of the significant channels through which the board and the audit committee discharge their governance responsibilities is through meetings. Frequent and regular meetings provide an opportunity for continuous and contemporary assessment of strategy, managerial performance, financial reporting and regulatory compliance. Recognizing the importance of these meetings, regulations in many countries specify that the board and the audit committee should meet a minimum number of times, and at periodic intervals within a year. The erstwhile Clause 49 regulations, that have now been replaced by Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, require that the Board and the Audit Committee must meet at least four times a year² with a maximum gap of 120 days between two meetings.

The success of these meetings in achieving governance objectives depends, however, not only on these specifications (i.e., minimum number of meetings in a year and the maximum gap between meetings), but also on having meetings of sufficient duration that allow exhaustive deliberation and discussion of agenda items. While the former is explicitly provided by regulations, the latter, which basically relates to the process of the meetings, is not. The importance of the duration and quality deliberations is, however, implicitly recognized by the regulations through mandates for (a) companies to record director attendance and (b) limits on directorships that an individual can have, to ensure that directors, especially outside directors, find enough time to devote to each company for discharging the responsibilities placed on them. Constituting and following an effective board and audit committee meeting process is thus the ‘spirit’ of the regulations.

Do companies adhere to this spirit of regulation? This of course is not directly observable but perhaps can be inferred from some observable characteristics. One such observable characteristic is whether board and audit committee meetings are held on different days. Though the law does not require that board and audit committee meetings be held on different days, given the large set of duties and responsibilities entrusted to the board and the audit committee, it is reasonable to postulate that directors would be overstretched if both these meetings were held on the same day on several occasions. The duties and responsibilities entrusted to the audit committee are quite demanding and have increased manifold over the years. Under such circumstances, holding the board meeting and the audit committee meeting on the same day is likely to put an onerous burden on directors serving on both the board and the audit committee and runs the danger of insufficient amount of time spent on meaningful discussion and deliberation of agenda items.

II. Stylized Facts on Board and Audit Committee Meetings

With this background, we undertake an analysis of the data on board and audit committee meetings of the top 500 listed companies for a seven year period starting from the year 2006 when a substantially revised version of the Clause 49 regulations came into effect, till the year 2012. Our analysis comes up with the following stylized facts:

a. Compliance in Letter

Number of Meetings

- All companies are found to be compliant with the erstwhile clause 49 regulations with respect to the number of board meetings save some minor non-compliance (three companies) between 2006 and 2012 (**Table 1**).
- However, the percentage of companies holding six or more board meetings declined from 72 percent in 2006 to 51 percent in 2012. While the percentage of companies holding four board meetings doubled from 12 percent in 2006 to 24 percent in 2012, the percentage of companies holding five³ board meetings increase from 16 percent in 2006 to 27 percent in 2012.
- These figures suggest that by 2012, the number of board meetings held in half of the companies was just about enough to comply with the erstwhile Clause 49 regulations.

²Under the new regulations notified on April 17, 2014.

³Holding five Board meetings may be necessary to comply with the interval restrictions between Board meetings within a year.

- With respect to number of audit committee meetings, there was a significant increase in the compliance rate over the years. While 90 percent of the companies complied with the erstwhile Clause 49 requirement in 2006, this figure had increased to 99 percent by 2012 (**Table 2**).
- However, while 40 percent of the companies held exactly four audit committee meetings in 2006, this figure had increased to 51 percent by 2012 (**Table 2**). Simultaneously, the percentage of companies conducting five audit meetings declined from 23 percent in 2006 to 18 percent in 2012.
- Taken together, the above findings imply that by 2012, the number of audit committee meetings also gravitated towards the prescribed regulatory minimum.

Gap Between Meetings

- During the entire period of 2006 to 2012, compliance with respect to the gap between board meetings (56 percent of companies) is much less as compared to the gap between audit committee meetings (93 percent companies).⁴
- The percentage of companies complying with the board meeting interval regulation has decreased significantly from nearly 61 percent in 2006 to 44 percent in 2012.
- The percentage of companies complying with the audit meeting interval regulation, which was already high, increased marginally from 92 percent in 2006 to 94 percent by 2012.

b. Compliance in Spirit

Incidence of Same Day Meetings

- Taking the entire period of 2006 to 2012, nearly 40 percent of the companies held same-day meetings at least four times in a year (**Table 3**).
- There is remarkable change in the intensity of same-day meetings between 2006 and 2012. While 34 percent of the companies held same-day board and audit committee meetings at least four times in 2006, by 2012 this figure had increased to 49 percent.
- Significantly, the increase in incidence of same-day meetings is also centered around four which is the regulatory minimum number for both board meetings and audit committee meetings. Thus, while 27 percent of the companies held their board meetings and audit committee meetings on 4 occasions in 2006, by 2012 this had increased to 39 percent.
- Detailed year to year analysis from 2006 to 2012 shows that there is a monotonic increase in the percentage of companies holding same-day meetings on 4 occasions.
- Companies which held same-day board and audit committee meetings on 4 to 6 occasions also held 4 to 6 board meetings and audit committee meetings in the financial year. This shows that these companies held nearly all of their board and audit committee meetings on the same day.

III. Are there Genuine Drivers for Same-day Meetings?

Notwithstanding the above stylized facts, companies may prefer to hold same-day board and audit committee meetings for several reasons. One principal reason could be to ensure higher attendance of its directors, especially those who hold multiple directorships in other companies and therefore have to attend meetings in those companies as well. Yet another reason of holding same day meetings could be that higher attendance expected in same-day meetings could be beneficial to harness the expertise of as many directors as possible to chalk out a strategy of financial turnaround. There could be other potential drivers like number of meetings held, and size of the company. We analyze these potential drivers now (**Table 4**).

⁴Table not reported to conserve space.

- **Number of Meetings:** Did the companies which held many same-day board and audit committee meetings also hold more number of board and audit meetings so that some of these meetings were held on the same day? Table 4 shows that the average number of board meetings held by these companies was actually lower compared to those which always (or most of the time) held their board and audit committee meetings on different days.
- **Poor Performance of Companies:** Were the companies which held more same-day meetings also poor performing companies in the past so that the need for board and audit committee deliberation and the importance of director attendance was relatively high? As the descriptive statistics show, previous year's profitability of these companies (measured by rate of return on assets), is not significantly lower compared to companies which held their board and audit committee meetings on different days.
- **Small Size Companies:** Were the companies which held higher number of same-day meetings also small companies, where the need for board and audit committee oversight is relatively less due to lower complexity of operations? Again, the descriptive statistics show no evidence of this.
- **Busy Directors:** Did the companies which held same-day meetings also have directors with many directorships in other companies which made same-day meetings convenient for them? As Table 4 shows, neither the number of multiple directorships nor the percentage of busy independent directors (i.e. those with six or more directorships) varies significantly and systematically with the number of same-day Board and audit committee meetings.
- **Increased Attendance by Outside Directors:** Did attendance of independent directors increase due to same-day meetings? As the descriptive statistics show, the percentage of board meetings attended by independent directors⁵ did not increase with the incidence of same-day meetings. Attendance of Annual General Meeting too did not vary significantly with the incidence of same-day board and audit committee meetings.
- **Governance Structures:** Is the incidence of same-day meetings correlated with poor governance structures? As Table 4 shows, while audit committee independence (as proxied by percentage of independent directors in the audit committee) does not exhibit any systematic variation, board independence declines with same-day board and audit committee meetings and the percentage of companies with an inside director present in the audit committee increases significantly.

IV. Conclusion

The stylized facts presented above show that almost all companies held the minimum number of four board meetings and four audit committee meetings as required under the regulation during the period 2006 to 2012. However, nearly 40 percent of the companies held same day board and audit committee meetings on at least on 4 occasions with this percentage increasing significantly and continuously between 2006 and 2012. A regression analysis indicates that the incidence of same-day board and audit committee meetings does not correlate with number of meetings held, poor past performance and directors being busy. Instead the incidence of same-day meetings correlates with poor governance structures captured by lower board size, lower percentage of independent directors on the board and the presence of inside directors in audit committees. Finally, the holding of same-day board and audit committee meetings does not lead to higher attendance by directors that is purportedly the most important driver of same-day board and audit committee meetings.

Taking all these observations together, the empirical analysis suggests that a large number of companies may be holding their board and audit committee meetings just to meet compliance requirements. Thus, while compliance in letter is high, compliance in spirit is low. Admittedly, this inference is indirect but the several observed empirical regularities lend credence to this inference.

⁵For this analysis we consider only the attendance record of the outside (or non-executive) independent directors since the scheduling of same-day Board and Audit Committee meetings ought to be driven by them rather than the availability of inside (or executive directors) who are most likely to be present anyway.

V. Way Forward

The solution to this issue may not lie in making an explicit regulation to avoid same-day board and audit committee meetings. It would be more useful for regulators to undertake a systemic analysis and disseminate the meeting dates to make companies aware that there is investor and regulatory oversight in the way compliance to board and audit committee meetings' regulations is being achieved. Such dissemination, along with structural reforms that strengthen the board and especially the audit committee in terms of its independence, diligence and financial literacy, can make companies choose the optimal way of conducting board and audit committee meetings that meet the spirit of regulation.

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Table 1: Distribution of Companies by Number of Board Meetings

No. of Board Meetings	All Years		2006		2012	
	No. of Companies	%	No. of Companies	%	No. of Companies	%
Less than 4	3	0.10	0	0.00	0	0.00
4	519	14.51	52	11.69	111	23.56
5	708	21.61	70	15.73	128	27.17
6	647	18.09	88	19.90	85	18.04
7	407	12.42	66	14.83	39	8.28
8	251	7.66	46	10.34	24	5.09
9	173	5.28	23	05.17	20	4.24
10	119	3.93	18	4.04	14	2.97
More Than 10	449	13.70	82	18.42	50	10.61
Total	3276	100	445	100	471	100

Table 2: Distribution of Companies by Number of Audit Committee Meetings

No. of Audit Committee Meetings	All Years		2006		2012	
	No. of Companies	%	No. of Companies	%	No. of Companies	%
Less Than 4	76	2.33	43	9.82	6	1.28
4	1379	42.34	175	39.95	238	50.85
5	815	25.02	100	22.83	85	18.16
6	420	12.89	51	11.64	59	12.60
7	197	5.57	30	6.84	27	5.77
8	124	3.80	8	1.82	21	3.70
9	76	2.33	11	2.51	5	1.07
10	60	1.84	8	1.82	9	1.58
More Than 10	85	2.61	2	0.45	19	4.06
Total	3232	100	438	100	468	100

Table 3: Distribution of Companies by Number of Same Day Board Meetings and Audit Committee Meetings

No. of times Board Meetings and Audit Committee Meetings held on same day	All Years		2006		2012	
	No. of Companies	%	No. of Companies	%	No. of Companies	%
0	675	20.78	121	27.62	68	14.71
1	236	07.26	43	09.81	35	07.57
2	391	12.03	52	11.87	52	11.15
3	582	17.91	74	16.89	80	17.31
4	1037	31.92	118	26.94	180	38.96
5	297	09.14	26	05.93	41	08.87
6 or more	30	00.92	4	00.91	6	01.30
Total	3248	100	438	100	462	100

Table 4: Relation of Same Day Board Meetings and Audit Committee Meetings, With Company Characteristics and Director Attendance

		No. of Times Board Meetings and Audit Committee Meetings Held on Same Day						
		0	1	2	3	4	5	>= 6
No. of Board Meetings	Mean	8.37	9.61	8.61	7.08	5.23	6.16	6.63
No. of Audit Meetings	Mean	5.53	5.63	5.63	5.11	4.72	5.47	6.57
Last Year Profitability (ROA)	Mean	0.15	0.12	0.14	0.15	0.15	0.15	0.16
Size of Company (log Sales)	Mean	10.32	10.73	10.68	10.31	10.05	10.02	10.65
No. of Directorships by Independent Directors	Mean	4.89	4.66	4.63	5.00	5.23	4.71	4.73
% of Independent Directors with Six or more Directorships	Mean	20.21	20.24	18.93	20.40	21.84	18.46	19.96
% of Board Meetings Attended by Independent Directors	Mean	75.34	74.85	74.16	73.92	73.76	73.12	73.24
% of Independent Directors who Attended the Annual General Meeting	Mean	61.42	59.81	61.20	61.46	60.82	61.92	60.40
% of Independent Directors	Mean	54.20	54.08	53.85	52.43	52.84	51.90	51.48
in the Audit Committee	Mean	75.76	77.61	74.38	78.09	78.69	77.22	69.61
% of Companies in which an Inside Director is Present in the Audit Committee	Mean	20.71	24.74	24.12	25.62	26.23	26.71	27.39

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