Pre-empting drift towards disaster

When analysing the root cause of any corporate debacle, it is not fair to focus upon the management's actions alone but to make a holistic review of the firm's "governance ecology", as no outcome can be contemplated without understanding the structural reasons for the failure.

The role of the board of directors, internal controls, statutory audits and regulatory oversights are all components of the governance ecology and their relative impacts also need to be scrutinised. Any diagnosis of these outcomes often gets mired in a blame game, which unfortunately take the focus away from its containment and resolution. These forgone assumptions should be avoided as they undermine the efforts of stakeholders to contain crises and to apply the learnings from the failings.

For any corporate failure, one must deep dive to see if the board adhered to the governance guidelines and exercised sufficient diligence in management representations. Especially the role of independent directors over the years, which is now magnified as this significantly strengthens governance. Their independence is imperative to the company's overall interests.

Worldly Wise

By Tariq Chauhan
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When undertaking a diagnostic review of financial statements, understand the application of the governance policy on the treatment of doubtful/bad debts, compliance with principles of revenue recognition, and potential impairment of receivables.

Did the board just follow the formality of ticking the checklist, thereby establishing their own complicity in faulty decision making? Or did the board function in line with guidelines in all its deliberations and the decision making formalised and recorded?

An independent audit provides another corporate governance limb to safeguard companies. This process seems to have been strengthened with the enforcement of international accounting standards promoting transparency and standardised disclosures. However, a fundamental issue remains.

There is a need to move away from practice of a random sample approach and instead employ forensic tools to ensure closer scrutiny of large ticket transactions in balance-sheets. Audits need to take a saner view of how the company's management has treated the key accounting provisions that can have material impact on financial statements. The role of internal audits is often understated although it should be the one raising the red flag at an early stage of any corporate disaster in the making. Not necessarily review them as a whistleblower, but ensure the management follows due processes.

Finally, the role of the regulator oversees the whole of the corporate governance function to be an important player in safeguarding shareholders. Regulators have the power to establish rules of engagement, monitor compliance, investigate breaches and make recommendations to penalise offenders in both a corporate and personal capacity. Irrespective of whether it is a public or private joint stock company, this role is vital and assumes centrestage in times of any corporate turbulence and has the power to step in to protect shareholder interests.

Businesses are jostling to maintain continuity and profitability while regulators and governments are debating to improve governance. But what is fundamentally needed is to strengthen the principles of business prudence and self-accountability.

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