India Policy and Asia-Pacific Regional Policy – Director Elections – Auditor Fees

Background and Overview

One generally accepted principle of global corporate governance best practice is the responsibility of the audit committee to ensure independent oversight of a company's financial reporting and internal control systems. Part of this responsibility is to ensure the independence of the company's statutory external auditor. The payment of excessive fees for services from the auditor not directly related to the audit function is recognized as potentially posing a conflict of interest that could impair the auditor's independent judgement. Further, failure to disclose sufficient information regarding the fees paid to the auditor in the last fiscal year raises concerns that the company is not being transparent about its relationship with its auditor.

The proposed policy change will generally align the policies for Bangladesh, India, Malaysia, Philippines, Pakistan, Thailand, and Sri Lanka with other ISS Asian market policies and also has the intent to encourage issuers to improve the disclosure of auditor fees.

Key Changes Under Consideration

ISS proposes to update the policies for the India and Asia-Pacific Regional policies for the election of directors to hold audit committee members accountable if the company is considered to have paid excessive non-audit fees or if the company did not disclose sufficient information about the fees paid to its auditors. The non-audit fees will generally be considered excessive if the non-audit fees have constituted more than 50 percent of the total auditor compensation during the fiscal year. In cases of payment of excessive non-audit fees or inadequate disclosure on the details of the auditor remuneration, ISS will issue negative vote recommendations on the election of all audit committee members who appear on the ballot.

Intent and Impact

The proposed policy would hold audit committee members accountable if the company paid excessive non-audit fees to the auditors or if the company has not provided sufficient disclosure on the details of the auditor remuneration.

India's Companies Act of 2013 was recently amended such that companies are no longer required to ratify the appointment of statutory auditors on an annual basis at the AGM. Audit firms in India generally serve up to two terms of five consecutive years. While some companies put to vote the appointment of statutory auditors and/or their remuneration, other companies opted not to put any auditor-related proposal on ballot as the auditors are serving their respective terms. The proposed policy will apply whether the appointment of the statutory auditors and/or its remuneration is on the ballot or not.

The policy change will align the treatment for Bangladesh, India, Malaysia, Philippines, Pakistan, Thailand, and Sri Lanka with other Asian markets such as Hong Kong and Singapore.
The proposed policy update will likely result in an increase in the number of ISS recommendations against the election of directors.

If the proposed policy had been applied in Bangladesh, Malaysia, Philippines, Pakistan, Thailand, and Sri Lanka, ISS may have issued adverse vote recommendations at approximately 11 percent of the total companies for these markets in 2017, and 15 percent in 2018. If the proposed policy had been applied in India, ISS may have issued adverse vote recommendations at 10 percent of the total companies for this market in 2017, and 13 percent in 2018. In the case of India, a partial application of the proposed policy was adopted in 2018 in view of recent regulatory changes regarding the ratification of auditors.

Request for Comment

While we will appreciate any comments on this topic, ISS specifically seeks feedback on the following:

- Does your organization agree with the proposed approach to identifying excessive non-audit fees? If not, please explain.
- If a company paid excessive non-audit fees to the auditors or if the company has not provided sufficient disclosure on the details of the auditor remuneration, should all audit committee members be held accountable? If no, please explain.
- For Bangladesh, Malaysia, Philippines, Pakistan, Thailand, and Sri Lanka, the proposed policy update is not driven by any particular change in regulation for these markets. Should ISS consider applying a transition period for implementation of its proposal? If yes, please specify the beginning year of when ISS's proposal should take effect?