CHAPTER 3

CORPORATE GOVERNANCE: REGULATIONS,
OPERATION AND IMPLEMENTATION

3.1 Introduction

Corporate Governance (CG) aims at protecting the interest of stakeholders, mainly equity shareholders, who provide capital to companies without any assurance of returns. The corporate form of business has entailed huge amounts of capital, which are mobilized by firms in the financial markets.

3.1.1 ISSUE OF CAPITAL AND CG

Adequate regulation of financial markets will also facilitate CG regulations. It is apparent that that CG emerged mainly on account of corporate frauds and also as a part of economic reforms. The frauds related to deceit in issue of capital, expropriation or tunnelling of corporate resources, inadequate disclosures of assets and liabilities etc. The factors which triggered an improvement in regulation in the Indian capital market, especially after economic reforms, were a lack of a developed secondary market, price manipulation, inadequate financial disclosure and insider trading, to name a few.¹ A well-developed capital market facilitates trading and brings down the cost of capital for companies. In a broader sense, measures that provide for adequate transparency and disclosures for proper control and regulations of various aspects of issue of capital are part of CG regulations. Exhibit 3.1 presents a snapshot of laws pertaining to the issue of capital in India.
EXHIBIT 3.1
ISSUE OF CAPITAL AND CG: A REGULATORY FRAMEWORK

Central Government

Ministry of Corporate Affairs (MCA)
Department of Company Affairs (DCA)

Company Law Board

Provisions on Accounting Standards and Standards on Audit

Various Amendments to Companies Act, 1956

National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 by MCA, supported by Indian Institute of Corporate Affairs, India

Proposed Companies Bill 2009

Interest of Stakeholders

National Foundation for Corporate Governance (NFCG), MCA

Voluntary Corporate Governance Guidelines, 2009

National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 by MCA, supported by Indian Institute of Corporate Affairs, India

Corporate Social Responsibility Voluntary Guidelines, 2009 by MCA, Government of India

Securities Contracts (Regulation) Act, 1956

The Securities and Exchange Board of India (SEBI) 1988 (SEBI Act, 1992)

Stock Exchanges (Bombay Stock Exchange (BSE) in 1875)

Revised Clause 49 of the Listing Agreement (on 1.1.2006)

Capital Issues (Control) Act, 1947

Defence Rule of India, 1943

Companies Act, 1956

Central Government

Central Government

Central Government

Central Government

Central Government
3.1.1.1 **Defence Rule of India, 1943.** During World War II, the Defence Rule of India, 1943 was in force to monitor and restrict capital flow into production of essential commodities.\(^2\)

3.1.1.2 **The Capital Issues (Control) Act 1947.** The office of the Controller of Capital Issues (CCI) was set up to implement this Act. The CCI was empowered to administer all matters of the capital market in relation to type, size, timing and price of issue.\(^3\) Some objectives of this Act were: ensuring growth of capital market, encouraging growth of companies with a strong capital structure, safety of investors and avoiding bunching of public issues.

3.1.1.3 **The Securities Contracts (Regulation) Act, 1956.** Due to the growth of the capital market, the Capital Issues Control Act, 1947 proved inadequate; the government felt the need for improved regulation.\(^4\) So it came up with the Securities Contracts (Regulation) Act, 1956 to monitor matters relating to issue of capital. The main objective of this Act has been to support Indian industry as per five-year plans and to infuse confidence among industrialists and other investors. The Act has undergone amendments relating to prospectus, disclosures of accounting and financial matters and listing of securities.

3.1.1.4 **Company Law Board.** The Company Law Board (CLB) was established to resolve grievances related to stock exchanges, companies and brokers.\(^5\) The CLB gave rulings in consonance with the Companies Act in order to protect interests of the investors. For instance, cases of default in payment of interest or principal by the companies are referred to the CLB. Since the commencement of the Companies (Second
Amendment) Act, 2002, the CLB stood dissolved and all matters or cases pending before the CLB were transferred to the National Company Law Tribunal.\(^6\)

3.1.1.5 **Companies Act, 1956.** The Companies Act, 1956 has been one of the stellar legislations introduced in India. It is virtually a Bible for companies.\(^7\)

3.1.1.6 **SEBI Act, 1992.** The SEBI was established in 1988 by an ordinance and its primary function is to govern the capital market with special emphasis on protecting the interest of small investors.\(^8\) It was formally established by the SEBI Act, 1992. Since its creation, SEBI has been vigorously active and has produced detailed guidelines for Initial Public Offers, Issue of Bonus Shares and Insider Trading to name a few areas.

3.1.2 **CG REGULATIONS**

‘Rules’ are typically believed to be simpler to adhere to than principles, as they demarcate a clear line between acceptable and unacceptable behaviour.\(^9\) Rules also limit discretion on the part of individual managers and auditors. However, in practice rules can be more complex than principles. Even if clear rules are followed, one can still find a way to get around their underlying purpose. However, this is more difficult if one is bound by a broader principle. ‘Principles’, however, are a form of self-regulation. Principles facilitate in determining standards that are acceptable or otherwise. Rules may be inadequate to deal with new transactions or issues which are not covered by the code. A code is a set of written rules which state how people in a particular organization or country should behave.
It is necessary for companies to adhere to the codes or principles and requirements of CG and to provide relevant information to all stakeholders regarding the performance, policies and procedures of a company in a transparent manner.\textsuperscript{10} There should be satisfactory financial and non-financial disclosures by the companies relating to, for example, remuneration package, financial reporting, auditing and internal controls. There are some areas that need special attention viz., quality of audit, which is at the root of effective CG, role of Board of Directors, accountability of the Chief Executive Officers (CEOs), of the Chief Financial Officers (CFOs), and quality and effectiveness of the legal, administrative and regulatory framework.

A robust regulatory framework and its enforcement is the foundation for ensuring good CG. The regulatory environment provides norms for the functioning of stock market, conduct of stock market intermediaries, corporate practices and CG (Exhibit 3.2). It is the responsibility of the regulatory authorities to ensure that the interests of stakeholders are protected, in particular the shareholders. The regulatory authorities direct and control CG through regulatory framework in the form of mandatory compliance. Brokers represent an important link between various investors. The effectiveness of capital market also depends upon fair practices by brokers. Among other things, investors feel protected when conduct of brokers is investor-friendly. To achieve this, effective functioning of the stock market is also important. Therefore, stock exchanges must ensure that integrity is maintained in the transaction process between the transacting parties.
CG codes and regulations have been developed in different countries and issued by stock exchanges, corporations, institutional investors, associations/institutes of directors, various committees and also by regulatory and international organizations (Exhibit 3.3). Compliance with CG recommendations is mostly mandatory, except in a few countries. For example, companies whose stocks trade on the London and Toronto
Stock Exchanges need not formally adhere to the recommendations of their respective national codes. However, they must disclose whether they follow the recommendations failing which, they should provide explanations. Such disclosure requirements put considerable pressure on companies for compliance. In the United States of America (US), companies are primarily regulated by the state in which they are incorporated and also by the federal government. Further, if such companies are public companies, then they are expected to adhere to norms of their stock exchanges. The highest numbers of companies are registered in Delaware, including over half of the Fortune 500. This is due to Delaware's conducive corporate legal environment and the existence of a state court dedicated exclusively to business issues. Most states generally follow the American Bar Association's Model Business Corporation Act while Delaware does not, but considers its provisions.

The instance of the General Motors Board Guidelines reflects the company’s efforts to improve its CG. Such CG guidelines, may have a wider demonstration effect inspiring other companies to adopt standards of best practice. As for exemplary committees, it is the Cadbury Committee (1991) established in United Kingdom (UK). The Organization for Economic Co-operation and Development (OECD) also framed influential principles of CG in 1999 which were revised in 2004.

The OECD’s work has been the basis for other international organizations such as the United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting which has a produced voluntary guidance on ‘Good Practices in Corporate Governance Disclosure’.
The World Business Council for Sustainable Development has also contributed to CG, particularly on accountability and reporting, which in 2004 culminated in an ‘Issue Management Tool’ i.e., ‘Strategic Challenges for Business in the use of Corporate Responsibility Codes, Standards, and Frameworks’.

3.1.3 ORGANIZATIONAL FRAMEWORK FOR CG IN INDIA

The organizational framework for CG initiatives in India consists of the MCA and the SEBI. A self-regulatory code was recommended by the Confederation of Indian Industries (CII) in 1997 (Exhibit 3.3). The first formal regulatory framework for listed companies in CG was established by the SEBI in February 2000, pursuant to the recommendations of the Kumar Mangalam Birla Committee Report. It materialized as Clause 49 of the Listing Agreement. The DCA also appointed a committee on ‘Corporate Audit and Governance’ in 2002 headed by Mr. Naresh Chandra to examine various CG issues. It offered recommendations on two important aspects of CG (i) financial and non-financial disclosures; and (ii) independent auditing and Board oversight of management. Subsequently, SEBI set up another committee headed by Mr. N. R. Narayana Murthy to review Clause 49 of the Listing Agreement and to suggest measures for uplifting CG standards. Some of the key recommendations of the committee pertained to Audit Committees, audit reports, Independent Directors, related party transactions, risk management, directorships and director compensation, codes of conduct and financial disclosures.

Global accounting scandals in the West produced a spate of regulations. CG reform has been a key priority for policy-makers around the world; it is reflected in the
enactment of legislations, most notably the Sarbanes Oxley (SOX) Act of 2002 in the US and Clause 49 in India. MCA also set up the NFCG (Exhibit 3.3) in association with the CII, Institute of Chartered Accountants of India (ICAI), Institute of Company Secretaries of India and National Stock Exchange as a not-for-profit trust. The objective is to provide a forum to discuss issues, experiences and ideas relating to CG and to impress upon corporate leaders the importance of good CG practices.

EXHIBIT 3.3
LIST OF SELECTED CODES AND REGULATIONS FOR CG

<table>
<thead>
<tr>
<th>Committee/ Legislation</th>
<th>Achievement</th>
<th>Background</th>
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<tbody>
<tr>
<td>2. Securities and Exchange Commission, 1977 (US)</td>
<td>Mandatory reporting on internal financial controls.</td>
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<td>3. Cadbury Committee, 1991 United Kingdom (UK), set up by London Stock Exchange, ‘Code of Best Practices’, December, 1992</td>
<td>It emphasized the accountability of the Board of Directors to shareholders and the society. Its recommendations are considered to be a landmark in the emergence of CG and is very often referred as the ‘foundation stone of CG’.</td>
<td>Several corporate scandals in 1980s and 1990s (collapse of famous corporations such as PollyPeck, Bank of Credit and Commerce International, Robert Maxwell’s Mirror Group International)</td>
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<td>4. Greenbury Committee, 1995 (UK)</td>
<td>The committee addressed the issue of directors’ remuneration.</td>
<td>An attempt for further reforms in the area of CG focusing specifically on remuneration of directors with the background of Cadbury Committee.</td>
</tr>
<tr>
<td>5. Hampel Committee, 1998 (UK)</td>
<td>The emphasis was on the extension of directors responsibilities to all relevant control objectives including business risk assessment and minimizing fraud.</td>
<td>To keep the momentum by assessing the impact of Cadbury Report and to suggest further guidelines.</td>
</tr>
<tr>
<td>6. Combined Code, 1998 introduced by London Stock Exchange (UK)</td>
<td>London Stock Exchange (UK) introduced the Combined Code, as part of Listing Agreement for compliance by listed British companies. It was predominantly based on the Cadbury and Greenbury Committee Reports.</td>
<td>Since the publication of Cadbury and Greenbury Committee Reports, there was pressure from various quarters to convert the voluntary codes into compulsory provisions through Listing Agreement.</td>
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<td>7. OECD Principles of Corporate Governance, 1999</td>
<td>OECD suggested the principles of CG both for its member governments and for its non-member governments in order to help them to bring out</td>
<td>The guidelines were evolved in recognition of growing awareness of the importance of good CG among OECD</td>
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<td>8.</td>
<td>The SOX Act, 2002 (US)</td>
<td>Both internal and external control systems have been tightened. There is a provision for ‘oversight’. This is considered to be a very stringent piece of legislation aimed at efficient management of corporations.</td>
</tr>
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<td>9.</td>
<td>National Task Force by CII in 1997, chaired by Rahul Bajaj ‘Desirable Corporate Governance : A Code’, India</td>
<td>CII was first to promote the ideal of CG in India to meet the demand for greater disclosure, transparent explanation for major decisions and increased shareholder value. The task force recommended a voluntary code for CG.</td>
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<td>10.</td>
<td>Kumar Mangalam Birla Committee, 1998 set up by SEBI, India</td>
<td>Its comprehensive recommendations comprised two parts- (i) mandatory and (ii) non-mandatory (voluntary) CG requirements.</td>
</tr>
<tr>
<td>11.</td>
<td>Amendment of Companies Act, 1998 and 2000, India</td>
<td>Several important provisions were legislated to improve the transparency and accountability of companies in India. Examples are Sections 211(3A) and (3B), 217(2AA), 275, 292A.</td>
</tr>
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<td>12.</td>
<td>Clause 49 of the Listing Agreement in 2000 under SEBI Act, 1992, India</td>
<td>SEBI introduced Clause 49 of the Listing Agreement through the stock exchanges in India for compliance by the listed companies. It was based on several recommendations of the Kumar Mangalam Birla Committee, 2000.</td>
</tr>
<tr>
<td>14.</td>
<td>Narayan Murthy Committee, 2003 set up by the SEBI, India</td>
<td>The committee reviewed the performance of CG in the country, the role of companies in responding to rumours and other price sensitive market information to enhance the transparency and integrity of the market. On many matters (e.g. Independence of Directors, Audit Committee and certification by CEOs and CFOs) the committee concurred with the Naresh Chandra Committee. It made two sets of CG recommendations: mandatory and non-mandatory.</td>
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<td>15.</td>
<td>J. J. Irani Committee, 2004 set up by Government of India</td>
<td>The committee evaluated structurally the views of several stakeholders in revamping the Companies Act in India. Many of its recommendations have found place in the Companies (Amendment) Bill, 2005. If enacted, will go a long way in achieving sustainable corporate growth.</td>
</tr>
<tr>
<td>16.</td>
<td>Revised Clause 49 of the Listing Agreement in 2004, India</td>
<td>SEBI’s circular on Listing Agreement (October, 2004) was used by the stock exchanges to revise Clause 49 to make its provisions internationally competitive for raising the standards of CG practices among listed companies and corporate bodies in India.</td>
</tr>
<tr>
<td>17.</td>
<td>National Foundation for Corporate Governance established by MCA, Govt. of India</td>
<td>Established by Government of India, MCA in partnership with CII, Institute of Company Secretaries of India, ICAI, Institute of Costs and Works Accountants of India and National Stock Exchange.</td>
</tr>
<tr>
<td>18.</td>
<td>Corporate Governance Guidelines for Public Sector Enterprises, 2007, India</td>
<td>CG Guidelines for Public Sector Enterprises prescribed by Central Government</td>
</tr>
<tr>
<td>19.</td>
<td>Corporate Governance Voluntary Guidelines, 2009 by MCA, India</td>
<td>Recommended voluntary guidelines for good CG over and above mandatory and non-mandatory requirements of Clause 49.</td>
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<tr>
<td>21.</td>
<td>National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 by MCA, supported by Indian Institute of Corporate Affairs, India</td>
<td>Recommended voluntary guidelines for good corporate management from wider perspective.</td>
</tr>
</tbody>
</table>

2 http://www.nfcgindia.org/aboutus.htm, website accessed on 18.12.2011, 5.30 p.m.
3 www.dpe.nic.in
4 http://www.mca.gov.in/Ministry/guideline_archieve.html, website accessed on 18.12.2011, 6 p.m.
5 http://www.mca.gov.in/Ministry/guideline_archieve.html, website accessed on 18.12.2011, 6 p.m.
6 http://www.nfcgindia.org/home.html, website accessed on 18.12.2011, 5.35 p.m.
3.1.4 SALIENT FEATURES OF CLAUSE 49 OF THE LISTING AGREEMENT*

The salient features of Clause 49 comprise mandatory and non-mandatory norms of CG.\(^{23}\)

3.1.4.1 Mandatory Provisions.

I. Board of Directors

(A) Composition of Board

In case of a Non-Executive Chairman, at least one-third of the Board should comprise Independent Directors and in case of an Executive Chairman, at least half the Board should comprise Independent Directors.

(B) Non-Executive Directors’ Compensation and Disclosures

All fees/compensation paid to Non-Executive Directors, including Independent Directors shall be fixed by the Board of Directors with approval by shareholders in general meeting except approval for payment of sitting fees to Non-Executive Directors if it is paid within limits prescribed by the Companies Act, 1956. Limits shall be set for the maximum number of stock options that can be granted to Non-Executive Directors including Independent Directors in any financial year and in the aggregate.

(C) Other Provisions as to Board and Committees

(i) The Board meeting shall be held at least four times a year, with a maximum time gap of four months between any two meetings.

*Clause 49 of Listing Agreement, applicable to companies’ with effect from 1\(^{st}\) January, 2006 is considered for the study.
(ii) A director shall not be a member in more than ten committees or act as chairman of more than five committees across all companies in which he is a director.

(D) Code of Conduct

(i) The Board of a company to lay down the code of conduct for all Board members and senior management of a company. This code of conduct shall be posted on the website of the company.

(ii) All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The annual report of the company shall contain a declaration to this effect signed by the CEO.

II. Audit Committee

(A) Qualified and Independent Audit Committee

(i) The Audit Committee shall have minimum three directors as members; two-thirds of the members of Audit Committee shall be Independent Directors;

(ii) all members of Audit Committee shall be financially literate and at least one member shall have accounting or related financial management expertise;

(iii) the Chairman of the Audit Committee shall be an Independent Director;

(iv) the Chairman shall be present at Annual General Meeting to answer shareholder queries;

(v) the Audit Committee should invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the
meetings of the committee, but on occasions it may also meet without the
presence of any executives of the company. The finance director, head of internal
audit and a representative of the statutory auditor may be present as invitees for
the meetings of the Audit Committee;

(vi) the Company Secretary shall act as the secretary to the Audit Committee.

(B) Meeting of Audit Committee

The Audit Committee shall meet at least four times a year. Not more than four
months should elapse between two meetings. The quorum shall be either two members or
one third of the members of the Audit Committee, whichever is greater but there should
be minimum of two Independent Directors present.

(C) Powers of Audit Committee

The Audit Committee shall have powers to (1) investigate any activity within its terms of
reference; (2) to seek information from any employee; (3) to obtain legal or other
professional advice from outside; and (4) to secure attendance of outsiders with relevant
expertise, if it considers necessary.

(D) Responsibilities of Audit Committee

1. Oversight of the company’s financial reporting process and the disclosure of its
financial information to ensure that the financial statements are correct, sufficient and
credible.

2. Recommending the appointment and removal of external auditor, fixation of audit fee
and also approval for payment for any other services.

3. Reviewing the annual financial statements with the management before submission to the Board. The focus would primarily be on:

(a) any changes in accounting policies and practices, (b) major accounting entries based on exercise of judgment by management, (c) qualifications in draft audit report, (d) significant adjustments arising out of audit, (e) the going concern assumption, (f) compliance with Accounting Standards, (g) qualifications in the draft audit report.

4. Reviewing, the annual financial statements with the management before submission to the Board for approval, with particular reference to:

a. Matters required to be included in the Director’s Responsibility Statement to be included in the Board’s report in terms of Clause (2A) (a) of Section 217 of the Companies Act, 1956;

b. Changes, if any, in accounting policies and practices and reasons for the same;

c. Major accounting entries involving estimates based on the exercise of judgment by management; significant adjustments made in the financial statements arising out of audit findings;

d. Compliance with listing and other legal requirements relating to financial statements;

e. Disclosure of any related party transactions;

f. Qualifications in the draft audit report.
5. Reviewing, the quarterly financial statements with the management before submission to the Board for approval.

5A. Reviewing, with the management, the statement of uses/application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilization of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take steps in this matter.

6. Reviewing, the performance of statutory and internal auditors and adequacy of the internal control systems with the management.

7. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.

8. Discussion with internal auditors on significant findings and follow-up thereon.

9. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board.

10. Discussion with statutory auditors before commencement of the audit, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
11. To look into the reasons for substantial defaults in the payment to the depositors, debentureholders, shareholders (in case of non-payment of declared dividends) and creditors.

12. To review the functioning of the Whistle-Blower mechanism, if existing.

12A. Approval of appointment of CFO i.e., the Whole-Time Finance Director or any other person heading the finance function or discharging that function, after assessing the qualifications, experience and background of the candidate.

13. Carrying out any other function as mentioned in the terms of reference of the Audit Committee.

(E) Review of Information by Audit Committee

1. Management Discussion and Analysis (MD&A) of financial condition and results of operations;

2. Statement of significant related party transactions
   (as defined by the Audit Committee), submitted by management;

3. Management letters/letters of internal control weaknesses issued by the statutory auditors;

4. Internal audit reports relating to internal control weaknesses; and

5. The appointment, removal and terms of remuneration of the Chief Internal Auditor shall be subject to review by the Audit Committee.

III. Subsidiary Companies

(i) At least one Independent Director on the Board of Directors of the holding company shall be a director on the Board of Directors of a material non-listed Indian subsidiary company.
(ii) The Audit Committee of the listed holding company shall also review the financial statements, in particular, the investments made by the unlisted subsidiary company.

(iii) The minutes of the Board meetings of the unlisted subsidiary company shall be placed at the Board meeting of the listed holding company. The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.

IV. Disclosures

(A) Basis of Related Party Transactions

(i) A statement in summary form of transactions with related parties in the ordinary course of business shall be placed periodically before the Audit Committee.

(ii) Details of material individual transactions with related parties which are not in the normal course of business shall be placed before the Audit Committee.

(iii) Details of material individual transactions with related parties or others, which are not on an arm’s length basis, should be placed before the Audit Committee, together with management’s justification for the same.

(B) Disclosure of Accounting Treatment

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, that fact shall be disclosed in the financial statements, together with the management’s explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the CG report.
(C) Board Disclosures – Risk Management

The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

(D) Proceeds from Public Issues, Rights Issues and Preferential Issues

When money is raised through public issues, rights issues, or preferential issues, it shall disclose to the Audit Committee, the uses/applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and place it before the Audit Committee. Such disclosure shall be made only till such time that the full money raised through the issue has been fully spent. This statement shall be certified by the statutory auditors of the company. Where the company has appointed a monitoring agency to monitor the utilization of proceeds of a public or rights issue, it shall place before the Audit Committee the monitoring report of such agency, upon receipt, without any delay. The Audit Committee shall make appropriate recommendations to the Board to take steps in this matter.

(E) Remuneration of Directors

(i) All pecuniary relationships or transactions of the Non-Executive Directors vis-à-vis the company shall be disclosed in the annual report.
(ii) Further the following disclosures on the remuneration of directors shall be made in the section on CG of annual report:

a. All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options and pension.

b. Details of fixed component and performance-linked incentives, along with the performance criteria.

c. Service contracts, notice period and severance fees.

d. Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

(iii). The company shall publish its criteria of making payments to Non-Executive Directors in its annual report. Alternatively, this may be put up on the company’s website and reference drawn thereto in the annual report.

(iv). The company shall disclose the number of shares and convertible instruments held by Non-Executive Directors in the annual report.

(v). Non-Executive Directors shall be required to disclose their shareholding (both own or held by / for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment. These details should be disclosed in the notice to the general meeting called for appointment of such director.

(F) Management

i. As part of the directors’ report or as an addition thereto, a MD&A report should form part of the annual report to the shareholders. MD&A should include a discussion on the following matters within the limits set by the company’s competitive position: (1) industry structure and developments; (2) opportunities and threats; (3) segment-wise or
product-wise performance; (4) outlook; (5) risks and concerns; (6) internal control systems and their adequacy; (7) discussion on financial performance with respect to operational performance; (8) material developments in human resources / industrial relations front, including the number of people employed.

ii. Senior management shall make disclosures to the Board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g., dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)

(G) Shareholders

i. In case of the appointment of a new director or re-appointment of a director, the shareholders must be provided with the following information:
   a. A brief resume of the director;
   b. Nature of his expertise in specific functional areas;
   c. Names of companies in which the person also holds directorships and the membership of committees of the Board; and
   d. Shareholding of Non-Executive Directors as stated in Clause 49 (IV) (E) (v) above.

ia. Disclosure of relationships between directors inter-se shall be made in the annual report, notice of appointment of a director, prospectus and letter of offer for issuances and any related filings made to the stock exchanges where the company is listed.
ii. Quarterly results and presentations made by the company to analysts shall be put on company’s website, or shall be sent in such a form as to enable the stock exchange on which the company is listed to put it on its own website.

iii. A Board committee under the chairmanship of a Non-Executive Director shall be formed to specifically redress complaints of shareholders and investors relating to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This committee shall be designated as ‘Shareholders/Investors Grievance Committee’.

iv. To expedite the process of share transfers, the Board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

V. CEO/CFO Certification

The CEO, i.e., the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the Whole-Time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that:

a. They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief:

   i. these statements do not contain any materially untrue statement nor omit any material fact nor contain statements that might be misleading;
ii. these statements together present a true and fair view of the company’s affairs and are in compliance with existing Accounting Standards, applicable laws and regulations.

b. There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violate the company’s code of conduct.

c. They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.

d. They have indicated to the auditors and the Audit Committee:

   i. significant changes in internal control over financial reporting during the year;
   ii. significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
   iii. instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or any employee having a significant role in the company’s internal control system over financial reporting.

VI. Report on CG

   i. There shall be a separate section on CG in the annual reports of company, with a detailed compliance report on CG. Non-compliance of any mandatory
requirement of Clause 49 with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted. The suggested list of items to be included in this report is given in Annexure: 1 (IC) and the list of non-mandatory provisions given a few paragraphs later, under 3.1.4.2.

ii. The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format (Annexure: 1(IB)). Such report shall be signed either by the compliance officer or the CEO of the company.

VII. Compliance

1. The company shall obtain a certificate from either the auditors or practicing Company Secretaries regarding compliance of norms of CG as stipulated in Clause 49 and annex the certificate with the Directors’ Report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.

2. The non-mandatory requirements may be implemented as per the discretion of the company. However, the disclosures of the compliance with mandatory requirements and adoption (and compliance) /non-adoption of the non-mandatory requirements shall be made in the section on CG of the annual report.

3.1.4.2 Non-Mandatory Provisions.

1. The Board

In the Board, a Non-Executive Chairman may be entitled to maintain a chairman’s office at the company's expense and also be allowed reimbursement of expenses incurred in the
performance of his duties. Independent Directors may have a tenure not exceeding, in the aggregate, a period of nine years, on the Board of a company. The company may ensure that the person who is being appointed as an Independent Director has the requisite qualifications and experience which would be of use to the company and which, in the opinion of the company, would enable him to contribute effectively to the company in his capacity as an Independent Director.

2. Remuneration Committee

i) The Board may set up a Remuneration Committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company’s policy on specific remuneration packages for Executive Directors including pension rights and any compensation payment.

ii) To avoid conflicts of interest, the Remuneration Committee, which would determine the remuneration packages of the Executive Directors may comprise at least three directors, all of whom should be Non-Executive Directors, the Chairman of the committee being an Independent Director.

iii) All the members of the Remuneration Committee should be present at the meeting.

iv) The Chairman of the Remuneration Committee could be present at the Annual General meeting, to answer the shareholder queries. However, it would be up to the Chairman to decide who should answer the queries.

3. Shareholder Rights

A half-yearly declaration of financial performance including a summary of the significant events in last six months, may be sent to each household of shareholders.
4. Audit Qualifications

Company may move towards a regime of unqualified financial statements.

5. Training of Board Members

A company may train its Board members according to the business model and the risk profile of the company, their responsibilities as directors, and the best ways to discharge them.

6. Mechanism for Evaluating Non-Executive Board Members

The performance evaluation of Non-Executive Directors could be done by a peer group comprising the entire Board of Directors, excluding the director being evaluated. Peer group evaluation could be the mechanism to determine whether to extend/continue the terms of appointment of such directors.

7. Whistle-Blower Policy

The company may establish a mechanism for employees to report to the management about unethical behavior, actual or suspected fraud or violation of the company’s code of conduct or ethics or policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the chairman of the Audit Committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization.
3.1.5 SELECTED PROVISIONS OF THE COMPANIES ACT 1956 WITH RESPECT TO CG

The important legislations for regulating the entire corporate domain and for dealing with various aspects of companies are given in the Companies Act, 1956 and various Companies Bill. These laws have been amended from time to time, to bring more transparency and accountability in the provisions. Some provisions of Companies Act, 1956 (hereinafter, “the Act”) are as follows.24

1. Board of Directors

1.1 Minimum Number of Directors
According to Section 252 (1), every public company, other than a public company which has become such by virtue of Section 43(A) shall have at least three directors. (2) Every other company shall have at least two directors.

1.2 Number of Directorships
According to Section 275, after the commencement of this Act, no person shall, save as otherwise provided in Section 276, hold office at the same time as director in more than twenty companies.

1.3 Board Meetings
According to Section 285, in the case of every company, a meeting of its Board of Directors shall be held at least once in every three months and at least four such meetings shall be held in every year provided that the Central Government may, by notification in the Official Gazette, direct that the provisions of this Section shall not apply in relation to any class of companies or shall apply in relation thereto with exceptions.
1.4 Remuneration of Directors

According to Section 309 (3) a director who is either in the whole-time employment of the company or a Managing Director, may be paid remuneration either by way of a monthly payment or at a specified per cent of the net profits of the company or partly by one way and partly by the other provided that except with the approval of the Central Government as per Section 643a such remuneration shall not exceed five per cent of the net profits for one such director, and if there is more than one such director, ten per cent for all of them together.

(4) A director who is neither in the whole-time employment of the company nor a Managing Director may be paid remuneration either (a) by way of a monthly, quarterly or annual payment with the approval of the Central Government; or (b) by way of commission if the company by special resolution authorizes such payment provided that the remuneration paid to such director, or where there is more than one such director, to all of them together, shall not exceed -

(i) one per cent of the net profits of the company, if the company has a Managing or Whole-Time Director, [managing agent, secretaries and treasurers] or a manager;
(ii) three per cent of the net profits of the company, in any other case provided further that the company in general meeting may, with the approval of the Central Government, authorize the payment of such remuneration at a rate exceeding one per cent or, as the case may be, three per cent of its net profits.

(5) The net profits referred to in sub-sections (3) and (4) shall be computed in the manner referred to in Section 198, sub-section (1).
Fees for meetings of the Board and any committee thereof, attended by a director are paid on a monthly basis; such fees may continue to be paid on that basis for a period of two years after such commencement or for the remainder of the term of office of such director, whichever is less.

1.5 Term of Managing Director

According to Section 317 (1) no company shall, after the commencement of this Act, appoint or employ any individual as its Managing Director for a term exceeding five years at a time.

(2) Any individual holding at the commencement of this Act the office of Managing Director in a company shall, unless his term expires earlier, be deemed to have vacated his office immediately on the expiry of five years from the commencement of this Act.

(3) Nothing contained in sub-section (1) shall be deemed to prohibit the re-appointment, reemployment, or the extension of the term of office, of any person by further periods not exceeding five years on each occasion: provided that any such re-appointment, re-employment or extension shall not be sanctioned earlier than two years from the date on which it is to come into force.

2. Audit Committee

2.1 Composition of Audit Committee

Section 292A applies to all public companies having a paid-up capital of Rs. 5 Crore or more.

a) The Audit Committee to consist of

i) Not less than 3 directors.

ii) 2/3rd of which shall be directors other than Managing or Whole Time Directors.
b) Chairman to be elected by the members.

c) Chairman to attend Annual General Meeting.

d) Director in-charge of finance, internal auditor and statutory auditor shall attend the meetings without any right to vote.

2.2 Meetings of Audit Committee

Frequency of meetings is not specified in Section 292A. However, it states that Audit Committee should have periodical discussions with auditors regarding scope of audit and review of half-yearly and annual financial statements before submission to the Board and also ensuring compliance of internal control systems.

2.3 Quorum

No quorum has been specified in Section 292A. The quorum should, thus, be as per Articles of Association of the company.

2.4 Powers of Audit Committee

According to Section 292A (7), following are the powers of Audit Committee:

i) To investigate any matter in relation to items specified in Section 292A or referred to it by the Board.

ii) To have full access to information contained in the records of the company.

iii) To seek external professional advice if necessary.

3. Remuneration of Managerial Personnel

According to Section 387, the manager of a company may, subject to the provisions of Section 198, receive remuneration either by way of a monthly payment, or by way of a specified per cent of the "net profits" of the company calculated in the manner laid down in Sections 349 and 350 or partly by the one way and partly by the other provided that
except with the approval of the Central Government such remuneration shall not exceed in the aggregate five per cent of the net profits.

4. Loans to Directors

According to Section 295 (1) save as otherwise provided in sub-section (2), no company (hereinafter in this Section referred to as "the lending company") without obtaining the previous approval of the Central Government in that behalf shall, directly or indirectly, make any loan to, or give any guarantee or provide any security in connection with a loan made by any other person to, or to any other person by -

(a) any director of the lending company, or of a company which is its holding company or any partner or relative of any such director;
(b) any firm in which any such director or relative is a partner;
(c) any private company of which any such director is a director or member;
(d) any body corporate at a general meeting of which not less than twenty-five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors together; or
(e) any body corporate, the Board of Directors, Managing Director, or manager whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

5. Disclosure of Interest by Director

According to Section 299 (1) every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into, by or on behalf of the
company, shall disclose the nature of his concern or interest at a meeting of the Board of Directors.

(2) (a) In the case of a proposed contract or arrangement, the disclosure required to be made by a director under sub-section (1) shall be made at the meeting of the Board at which the question of entering into the contract or arrangement is first taken into consideration, or if the director was not, at the date of that meeting, concerned or interested in the proposed contract or arrangement, at the first meeting of the Board held after he becomes so concerned or interested.

6. Board’s Report

According to Section 217 (1) there shall be attached to every balance sheet laid before a company in general meeting, a report by its Board of Directors, with respect to -

(a) the state of the company's affairs;
(b) the amounts, if any, which it proposes to carry to any reserves in such balance sheet;
(c) the amount, if any, which it recommends should be paid by way of dividend;
(d) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the balance sheet relates and the date of the report;
(e) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed.

(2) The Board's report shall, so far as is material for the appreciation of the state of the company's affairs by its members and will not in the Board's opinion be harmful to the business of the company or of any of its subsidiaries, deal with any changes which have occurred during the financial year -
(a) in the nature of the company's business;

(b) in the company's subsidiaries or in the nature of the business carried on by them; and

(c) generally in the classes of business in which the company has an interest.

(2A)(a) The Board's report shall also include a statement showing the name of every employee of the company who -

(i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than such sum as may be prescribed; or

(ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than such sum per month as may be prescribed;

(iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the Managing Director or Whole-Time Director or manager and holds by himself or along with his spouse and dependent children, not less than two per cent, of the equity shares of the company.

(b) The statement referred to in clause (a) shall also indicate, -

(i) whether any such employee is a relative of any director or manager of the company and if so, the name of such director, and

(ii) such other particulars as may be prescribed.

Explanation: "Remuneration" has the meaning assigned to it in the explanation to section 198.

(2B) The Board’s report shall also specify the reasons for the failure, if any, to complete the buyback of equity shares within the time specified in sub-section (4) of section 77A.
(3) The Board shall also be bound to give the fullest information and explanations in its report aforesaid, or in cases falling under the provisions to Section 222, in an addendum to that report, on every reservation, qualification or adverse remark contained in the auditors' report.

7. Voting by Shareholders

7.1 Proxies

According to Section 176 (1) any member of a company entitled to attend and vote at a meeting of the company shall be entitled to appoint another person (whether a member or not) as his proxy to attend and vote instead of himself; but a proxy so appointed shall not have any right to speak at the meeting.

7.2 Voting to Be by Show of Hands in First Instance

According to Section 177 at any general meeting, a resolution put to the vote of the meeting shall, unless a poll is demanded under Section 179, be decided on a show of hands.

7.3 Demand for Poll

According to Section 179 (1) before or on the declaration of the result of the voting on any resolution on a show of hands, a poll may be ordered to be taken by the chairman of the meeting of his own motion, and shall be ordered to be taken by him on a demand made in that behalf by the persons or person specified below, that is to say, -

(a) in the case of a public company having a share capital, by any member or members present in person or by proxy and holding shares in the company -

(i) which confer a power to vote on the resolution not being less than one-tenth of the total voting power in respect of the resolution, or
(ii) on which an aggregate sum of not less than fifty thousand rupees has been paid up.

8. Quorum for Meetings of the Board

According to Section 287 (1) in this Section - (a) "total strength" means the total strength of the Board of Directors of a company as determined in pursuance of the Act, after deducting therefrom the number of the directors, if any, whose places may be vacant at the time; and (b) "interested director" means any director whose presence cannot, by reason of Section 300, count for the purpose of forming a quorum at a meeting of the Board, at the time of the discussion or vote on any matter.

(2) The quorum for a meeting of the Board of Directors of a company shall be one-third of its total strength (any fraction contained in that one-third being rounded off as one), or two directors, whichever is higher provided that where at any time the number of interested directors exceeds or is equal to two-thirds of the total strength, the number of the remaining directors, that is to say, the number of the directors who are not interested, present at the meeting being not less than two, shall be the quorum during such time.

9. Powers of SEBI

As per Section 55A, the provisions contained in 55 to 58, 59 to 84, 108 to 110, 112, 113, 116 to 122, 206, 206A and 207, so far as they relate to issue and transfer of securities and non-payment of dividend shall -

(a) in case of listed public companies;

(b) in case of those companies which intend to get their securities listed on any recognized stock exchange in India, be administered by the SEBI; and

(c) in any other case, shall be administered by the Central Government.
Explanation - for the removal of doubts, it is hereby declared that all powers relating to all other matters including those relating to prospectus, statement in lieu of prospectus, return of allotment, issue of shares and redemption of irredeemable preference shares shall be exercised by the Central Government [the Tribunal] or the Registrar of Companies, as the case may be.

EXHIBIT 3.4

COMPARATIVE REVIEW OF SELECTED PROVISIONS OF THE CLAUSE 49 OF THE LISTING AGREEMENT AND THE COMPANIES ACT 1956 RELATED TO CG

<table>
<thead>
<tr>
<th>Requirement as per Clause 49 of the Listing Agreement</th>
<th>Requirement as per Section of Companies Act, 1956</th>
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</thead>
<tbody>
<tr>
<td><strong>Composition of Board of Directors</strong></td>
<td><strong>Composition of Board of Directors</strong></td>
</tr>
<tr>
<td>I (A) At least 50 per cent of the total number of directors should be Non-Executive Directors. If chairman is an Executive Director, at least half of the total number of directors should be Independent Directors. If the chairman is a Non-Executive Chairman, at least 1/3rd of the total number of directors should comprise Independent Directors.</td>
<td>No such requirement under the Companies Act, 1956. In fact, the Companies Act, 1956 does not use the expressions ‘Independent Directors’ or ‘Non-Executive Directors’ or ‘Executive Directors’ or ‘Executive or Non-Executive Chairman’. As per Section 252 (1) at least three directors for a public company.*</td>
</tr>
<tr>
<td><strong>Directors Compensation and Disclosures</strong></td>
<td><strong>Directors Compensation and Disclosures</strong></td>
</tr>
<tr>
<td>I(B) and IV(E) The remuneration of Non-Executive Directors including Independent Directors to be decided by the Board of Directors with prior approval of shareholders in general meeting except approval for payment of sitting fees if such sitting fees is paid within limits prescribed by the Companies Act, 1956. All pecuniary relationship or transactions of the Non-Executive Directors vis-à-vis the company should be disclosed in annual report.</td>
<td>Section 309(1) of the Companies Act requires the remuneration of directors (whether Managing or Whole-Time Director) to be determined as per provisions of Section 198 either by articles or resolution or if articles require then by special resolution.* The Section 299 (1) requires disclosure by directors of their interests in contracts and arrangements with the company. It is only a disclosure of information (Form 24AA) and there is no requirement of stating the same in annual report as it is under Clause 49 except the disclosures to be made pursuant to Accounting Standard - 18: Related Party Disclosures.</td>
</tr>
<tr>
<td>II (A) <strong>Composition of Audit Committee</strong></td>
<td><strong>Section 292A</strong></td>
</tr>
<tr>
<td>a) The Audit Committee should consist of i) Minimum of 3 members, all being Non-Executive Directors. ii) 2/3rd should be Independent Directors. iii) All should be financially literate, but at least one director having financial and accounting knowledge. b) Chairman to be an Independent Director. c) Chairman to attend Annual General Meeting. d) Committee to invite Finance Director, head of internal audit, and representative of statutory</td>
<td>applies to all public companies having a paid-up capital of Rs. 5 Crore or more. <strong>Composition of Audit Committee</strong> a) The Audit Committee to consist of i) not less than 3 directors. ii) 2/3rd of which shall be directors other than Managing or Whole Time Directors. b) Chairman to be elected by the members. c) Chairman to attend Annual General Meeting. d) Director in-charge of finance, internal auditor and statutory auditor shall attend the meetings without any right to vote.</td>
</tr>
<tr>
<td>Meetings of Audit Committee</td>
<td>Meetings of Audit Committee</td>
</tr>
<tr>
<td>-----------------------------</td>
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</tbody>
</table>
| i) To meet at least four times in a year. | Frequency of meetings is not specified in Section 292A. 
   However, it states that Audit Committee should have periodical discussions with auditors regarding scope of audit and review of half-yearly and annual financial statements before submission to the Board and also ensuring compliance of internal control systems. |
| ii) Not more than four months to elapse between two meetings. | **Quorum** |
| **Quorum** | No quorum has been specified in Section 292A. The quorum should, thus, be as per Articles of Association of the company. |

<table>
<thead>
<tr>
<th>II(C) Powers of Audit Committee</th>
<th>292A(7) Powers of Audit Committee</th>
</tr>
</thead>
<tbody>
<tr>
<td>i) To investigate any activity within its terms of reference.</td>
<td>i) To investigate into any matter in relation to items specified in Section 292A or referred to it by the Board.</td>
</tr>
<tr>
<td>ii) To seek information from any employee.</td>
<td>ii) To have full access to information contained in the records of the company.</td>
</tr>
<tr>
<td>iii) To obtain outside legal or other professional advice.</td>
<td>iii) To seek external professional advice if necessary.</td>
</tr>
<tr>
<td>iv) To secure attendance of outsiders with relevant expertise if necessary.</td>
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</table>

<table>
<thead>
<tr>
<th>I(C) Frequency of Board Meetings</th>
<th>Frequency of Board Meetings</th>
</tr>
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<tbody>
<tr>
<td>The Board meetings shall be held at least four times a year, with a maximum time gap of four months between any two meetings.</td>
<td>As per Section 285, the Board meeting to be held once in every three months and at least four such meetings to be held every year. The gap between two meetings could be more than 4 months.</td>
</tr>
</tbody>
</table>

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<thead>
<tr>
<th>VI Report on Corporate Governance</th>
<th>Report on Corporate Governance</th>
</tr>
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<tbody>
<tr>
<td>The company shall have a separate section on corporate governance in annual reports of company, with a detailed compliance report on corporate governance. Non-compliance of any mandatory requirement i.e., which is part of the Listing Agreement with reasons thereof and the extent to which the non-mandatory requirements have been adopted to be specifically highlighted.</td>
<td>No separate report on corporate governance is required under the Companies Act, 1956.</td>
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</table>

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<thead>
<tr>
<th>VII Corporate Governance Compliance Certificate</th>
<th>Corporate Governance Compliance Certificate</th>
</tr>
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<tbody>
<tr>
<td>The company has to —</td>
<td>No such requirement under the Companies Act, 1956.</td>
</tr>
<tr>
<td>a) Obtain a certificate from auditors or company secretary of company regarding compliance of conditions of corporate governance as stipulated in this clause.</td>
<td></td>
</tr>
<tr>
<td>b) Such certificate is to be annexed with directors’ report, which is sent annually to all shareholders.</td>
<td></td>
</tr>
<tr>
<td>c) Send same certificate to Stock Exchanges along with annual returns filed by company.</td>
<td></td>
</tr>
</tbody>
</table>

3.1.6 SELECTED PROVISIONS OF PROPOSED COMPANIES BILL, 2009 WITH RESPECT TO CG

1. Board of Directors

Under Section 132 (1 to 6) every company shall have a Board of Directors consisting of only individuals as directors and shall have a minimum number of three directors in the case of a public company and a maximum of twelve directors, excluding the directors nominated by the lending institutions. One of the directors shall at least be a person ordinarily resident in India. The Central Government may prescribe the minimum number of Independent Directors in case of other public companies and subsidiaries of any public company. Independent Director in relation to a company, means a Non-Executive Director of the company, other than a nominee director.∗

∗Section 132 (5) of Companies Bill 2009, defines “Independent director”, in relation to a company, as a non-executive director of the company, other than a nominee director-
(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
(b) who, neither himself nor any of his relatives-
   (i) has or had any pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or its promoters, or directors amounting to ten per cent. or more of its gross turnover or total income during the two immediately preceding financial years or during the current financial year;
   (ii) holds or has held any senior management position, position of a key managerial personnel or is or had been an employee of the company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;
   (iii) is or has been an employee or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of-
      (A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or
      (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;
   (iv) holds together with his relatives two per cent. or more of the total voting power of the company; or
   (v) is a Chief Executive or director, by whatever name called, of any nonprofit organization that receives twenty-five per cent. or more of its income from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or
   (c) who possesses such other qualifications as may be prescribed.
Explanation - For the purposes of this section, “nominee director” means a director nominated by any institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, to represent its shareholding.
Source: http://www.mca.gov.in/ministry/companies_act.html
An Independent Director shall not be entitled to any remuneration, other than sitting fee, reimbursement of expenses for participation in the Board and other meetings and profit-related commission and stock options as may be approved by the members.

1.1 Minimum Number of Directors

As mentioned previously, according to Section 132 (1) every company shall have a Board of Directors consisting of only individuals as directors and shall have - (a) a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; and (b) a maximum of twelve directors, excluding the directors nominated by the lending institutions.

(2) One of the directors shall at least be a person ordinarily resident in India.

Explanation - for the purposes of this sub-section, ordinarily resident in India means a person who stays in India for a total period of not less than one hundred and eighty-two days in a calendar year.

1.2 Number of Directorships

Under Section 146 (1) no person, after the commencement of this Act, shall hold office as a director, including any alternate directorship, in more than fifteen public limited companies at the same time.

(2) Where a person accepts an appointment as a director in contravention of sub-section (1), he shall be punishable with fine which shall not be less than five thousand rupees but which may extend to twenty-five thousand rupees for every day during which the contravention continues.
1.3 Term of Managing Director

According to Section 174 (1) no company shall appoint or employ at the same time a Managing Director and manager.

(2) No company shall appoint or re-appoint any person as its Managing Director, Whole-Time Director or manager for a term exceeding five years at a time provided that no re-appointment shall be made earlier than one year before the expiry of his term.

(3) No company shall appoint any firm, body corporate or other association as its manager.

(4) No company shall appoint or continue the employment of any person as its Key Managerial Personnel who - (a) is below the age of twenty-one years or has attained the age of seventy years provided that appointment of a person who has attained the age of seventy years may be made by passing a special resolution;

(b) is an undischarged insolvent or has at any time been adjudged an insolvent;

(c) has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them; or

(d) has at any time been convicted by a court of an offence involving moral turpitude.

(5) A Managing Director, Whole-Time Director or manager shall be appointed by the Board of Directors at a meeting with the consent of all the directors present at such meeting, which shall be subject to approval by a special resolution at the next general meeting of the company provided that a notice convening Board or general meeting for considering such appointment shall include the terms and conditions of such appointment, remuneration payable and such other matters including interest, if any, of a director or directors in such appointments, if any.
(6) Subject to the provisions of this Act, where an appointment of a Managing Director, Whole-Time Director or manager is not approved by the company at a general meeting, any act done by him before such approval shall be deemed to be invalid.

1.4 Board Meetings

Under Section 154 (1) every company shall hold the first meeting of the Board of Directors within thirty days of the date of its incorporation and thereafter hold a minimum number of four meetings of its Board of Directors every year in such a manner that not more than 120 days shall intervene between two consecutive meetings of the Board except that the Central Government may, by notification, direct that the provisions of this sub-section shall not apply in relation to any class or description of companies or shall apply with modifications or conditions as may be specified in the notification.

1.5 Directors’ Remuneration

Under Section 176 (1) a director who is neither a Whole-Time Director nor a Managing Director of a company may be paid remuneration in the form of -

(a) fee for attending meetings of the Board or committees thereof in accordance with the articles; and (b) profit-related commission with the prior approval of members by a special resolution.

(2) If any director draws or receives directly or indirectly by way of remuneration any sum in excess of the amount under sub-section (1), he shall refund such sum to the company within thirty days.
2. Board Committees

2.1 Audit Committee

Under Section 158 (1) the Board of Directors of every listed company and such other class or description of companies, as may be prescribed, shall constitute an Audit Committee.

(2) The Audit Committee shall consist of a minimum of three directors with Independent Directors forming a majority and at least one director having knowledge of financial management, audit or accounts.

(3) The Chairman of an Audit Committee shall be an Independent Director.

(4) Every Audit Committee of a company existing immediately before the commencement of this Act shall, within one year of such commencement, be reconstituted in accordance with sub-sections (2) and (3).

(5) Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall include, among other things, the recommendation for appointment of auditors of the company, examination of the financial statements and the auditors’ report thereon, transactions of the company with related parties, valuation of undertakings or assets of the company, wherever it is necessary, evaluation of internal financial controls and related matters.

(6) The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review financial statements before their submission to the Board.
(7) The Audit Committee shall have authority to investigate into any matter in relation to the items specified in sub-section (5) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.

(8) The auditors of a company and the Key Managerial Personnel shall have a right to attend the meetings of the Audit Committee when it considers the auditor’s report but shall not have the right to vote.

2.2 Remuneration Committee

Under Section 158 (1) the Board of Directors of every listed company and such other class or description of companies, as may be prescribed, shall constitute a Remuneration Committee of the Board.

(10) The Remuneration Committee shall consist of Non-Executive Directors as may be appointed by the Board out of which at least one shall be an Independent Director.

(11) The Remuneration Committee shall determine the company’s policies relating to the remuneration of the directors, including the remuneration and other perquisites of the directors, Key Managerial Personnel and such other employees as may be decided by the Board.

2.3 Stakeholders Relationship Committee

Under Section 158 (13) Stakeholders Relationship Committee shall consider and resolve the grievances of stakeholders.

3. Remuneration of Managerial Personnel

Under Section 175 (1) a Managing or Whole-Time Director or a manager of a company may be paid remuneration either by way of a monthly payment or at a specified per cent
of the net profits of the company, computed in the manner prescribed, or partly by monthly payment and partly by the per cent of net profits.

(2) Where any insurance is taken by a company on behalf of its Managing Director, Whole-Time Director, manager, CEO, CFO or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, malfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel.

(3) Any director who is in receipt of any commission from the company and who is a Managing or Whole-Time Director of the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board’s report.

(4) Every person who contravenes the provisions of this section shall be punishable with fine which shall not be less than One Lakh Rupees but which may extend to Five Lakh Rupees.

4. Related Party Transaction

Under Section 166 (1) except with the consent of the Board of Directors of a public company accorded by a resolution passed at a meeting of the Board and subject to such conditions as may be prescribed, no such company shall enter into any contract or arrangement with a related party with respect to -

(a) sale, purchase or supply of any goods or materials, investments of company to be held in its own name;
(b) selling or otherwise disposing of, or buying, property of any kind;

(c) leasing of property of any kind;

(d) availing or rendering of any services;

(e) appointment of any agents for purchase or sale of goods, materials, services or property;

(f) appointment to any office or place of profit in the company or its subsidiary company; and

(g) underwriting the subscription of any securities or derivatives thereof, of the company;

provided that no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions not exceeding such sums, as may be prescribed, shall be entered into except with the prior approval of the company by a special resolution.

5. Loans to Directors

According to Section 163 (1) save as otherwise provided in this Act, no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom he is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person provided that nothing contained in this sub-section shall apply to-

(a) the giving of any loan to a Managing or Whole-Time Director-

(i) as a part of the conditions of service extended by the company to all its employees; or

(ii) pursuant to any scheme approved by the members by a special resolution;

(b) a company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an
interest is charged at a rate not less than the bank rate declared by the Reserve Bank of India (RBI).

6. Disclosure of Interest by Director

According to Section 162 (1) every director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the disclosures already made, then at the first Board meeting held after the change, disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding, in such manner as may be prescribed.

7. Prohibition of Insider Trading

According to Section 173 (1) no director or Key Managerial Personnel shall either on his own behalf or on behalf of any other person, deal in securities of a company, or counsel, procure or communicate, directly or indirectly, about any non-public price-sensitive information to any person, provided that nothing contained in this sub-section shall apply to any communication required in the ordinary course of business or profession or employment or under any law.

8. CFO Certification

Under Section 117 (1) the financial statement shall give a true and fair view of the state of affairs of the company or companies as at the end of the financial year and these statements must comply with the Accounting Standards notified under Section 119 and shall be in such form as may be prescribed.

(6) Where any company contravenes the provisions of this Section, the Managing Director, the Whole-Time Director in charge of finance, the CFO or any other person
charged by the Board with the duty of complying with the requirements of this Section and in the absence of any of the officers mentioned above, all the directors shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupee but which may extend to five lakh rupee, or with both.

9. Board’s Report

As per Section 120 (1) the financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board at least by the Chairman where he is authorized by the Board or by two directors out of which one shall be Managing Director or CEO or, in the case of a one-person Company, only by one director, for submission to the auditor for his report thereon provided that such financial statements shall be authenticated in such manner as may be prescribed.

(2) The auditors’ report shall be attached to every financial statement.

(3) There shall be annexed to every financial statement laid before a company in general meeting, a report by its Board of Directors, which shall include-

(a) the extract of the annual return as provided under sub-section (2) of Section 82,

(b) number of meetings of the Board,

(c) Directors’ Responsibility Statement,

(d) declaration by Independent Directors where they are required to be appointed under sub-section (3) of Section 132,

(e) report of the committee on directors’ remuneration,
(f) explanations or comments by the Board on every qualification, reservation or adverse remark made by the auditor in his report,

(g) particulars of loans, guarantees or investments under sub-section (2) of Section 164, and

(h) particulars of contracts or arrangements under sub-section (1) of Section 166.

(4) The Directors’ Responsibility Statement referred to in sub-section (3).

10. Voting by Shareholders

10.1 Proxy

According to Section 94, any member of a company entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf in writing or by electronic mode in such manner and subject to such conditions as may be prescribed provided that a proxy shall not have the right to speak at such meeting and shall not be entitled to vote except on a poll.

10.2 Voting by Show of Hands

As per Section 96 (1) at any general meeting, a resolution put to the vote of the meeting shall, unless a poll is demanded under Section 98 or the voting is carried out electronically, be decided on a show of hands.

(2) A declaration by the Chairman of the meeting of the passing of a resolution or otherwise by show of hands under sub-section (1) and an entry to that effect in the books containing the minutes of the meeting of the company shall be conclusive evidence of the fact of passing of such resolution or otherwise.
10.3 Voting through Electronic Means

As per Section 97 unless the articles provide otherwise, a member may exercise his vote at a meeting by electronic means in the manner as may be prescribed.

10.4 Demand for Poll

As per Section 98 (1) before or on the declaration of the result of the voting on any resolution on show of hands, a poll may be ordered to be taken by the Chairman of the meeting on his own motion, and shall be ordered to be taken by him on a demand made in that behalf.

10.5 Postal Ballot

Under Section 99 (1) notwithstanding anything contained in the Act, a company - (a) shall, in respect of such items of business as the Central Government may, by notification, declare to be transacted only by means of postal ballot; and (b) may, in respect of any item of business, other than ordinary business and any business in respect of which directors or auditors have a right to be heard at any meeting, transact by means of postal ballot in such manner as may be prescribed, instead of transacting such business at a General Meeting.

(2) If a resolution is assented to by the requisite majority of the shareholders by means of a postal ballot, then it shall be deemed to have been duly passed at a General Meeting convened in that behalf.

11. Class Action

According to Section 216 (1), any one or more members or class of members or one or more creditors or any class of creditors may, if they are of the opinion that the
management or control of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or creditors, file an application before the Tribunal on behalf of the members and creditors for seeking all or any of the following orders, namely -

(a) to restrain the company from committing an act which is *ultra vires* the Articles or Memorandum of the company;

(b) to restrain the company from committing breach of any provision of the company’s Memorandum or Articles;

(c) to declare a resolution altering the Memorandum or Articles of the company as void if the resolution was passed by suppression of material facts or obtained by misstatement to the members or creditors;

(d) to restrain the company and its directors from acting on such resolution;

(e) to restrain the company from doing an act which is contrary to the provisions of the Act or any other law for the time being in force;

(f) to restrain the company from taking action contrary to any resolution passed by the members.

12. Quorum for a meeting of the Board

As per Section 155 (1) the quorum for a meeting of the Board of Directors of a company shall be one-third of its total strength or two directors, whichever is higher, and the participation of the directors by video conferencing or by other electronic means shall also be counted for the purposes of quorum under this sub-section.

(2) Where at any time, the number of interested directors exceeds, or is equal to, two-thirds of the total strength of the Board of Directors, the number of directors who are not
interested directors and present at the meeting, being not less than two, shall be the quorum during such time.

13. Auditor Not to Render Certain Services

As per Section 127, an auditor appointed under this Act shall provide the company only such other services as are approved by the Board of Directors or the Audit Committee, as the case may be, but which shall not include any of the following services, namely:-

(a) accounting and book-keeping services; (b) internal audit; (c) design and implementation of any financial information system; (d) actuarial services; (e) investment advisory services; (f) investment banking services; (g) rendering of outsourced financial services; and (h) management services.

14. Powers of SEBI

As per Section 22, (a) in so far as they relate to issue and transfer of securities and non-payment of dividend by listed companies or those companies which intend to get their securities listed on any stock exchange in India, shall, except as provided under this Act, be administered by the SEBI by making regulations;

(b) in any other case, shall be administered by the Central Government.

Explanation - For the removal of doubts, it is hereby declared that all powers relating to all other matters including those relating to prospectus, return of allotment, issue of shares and redemption of preference shares shall be exercised by the Central Government, the Tribunal or the Registrar, as the case may be.
3.1.7 COMPARATIVE REVIEW OF EXISTING COMPANIES ACT 1956 AND PROPOSED COMPANIES BILL, 2009

In the light of the changes worldwide, the expectations from the proposed Companies Bill, 2009 (hereinafter, “the Bill”) relate to setting of certain standards, deregulation and simplification. The Bill contains provisions requiring certain corporate entities to have a Remuneration Committee which would frame the remuneration policy for managerial personnel and other directors/employees. The Remuneration Committee would also be required to furnish in an annual report, particulars of remuneration which would form part of the Directors’ Report to shareholders. Apparently, the proposed provisions are based on the Irani Committee report. The Irani Committee also suggested that there should be a clear link between responsibility and performance in relation to remuneration and that the policy underlying the directors’ remuneration should be properly communicated to the stakeholders. The recommendations of the Irani Committee and provisions of the Bill are at par with the norms prevailing in developed economies, e.g., the UK. This would enhance transparency in the matter of management remuneration.

The Parliamentary Standing Committee on Finance - 2010 (PSCF) has suggested to the MCA to insert provisions in the Bill for the mandatory rotation of the audit firm every five years, with an interval of three years before re-appointment. The proposed provisions seek to rotate the audit partner every three years, with an interval of three years before re-appointment.
Companies of many advanced economies are required to have a Nomination Committee for selecting directors. To be at par with international practices, the PSCF has recommended a change in the Bill so as to bring in the provision of the Nomination Committee. The provisions for fixed term for Independent Directors and committee for selection of Independent Directors are commendable. Oversees, performance evaluation of directors is not a new idea and it features in CG norms.

The extant Companies Act necessitates the approval of the Central Government for certain related party transactions but the Bill does away with the need for obtaining such approval. The Bill aims to widen the scope of a ‘related party’, since ‘Key Managerial Personnel’, apart from Whole-Time Directors will also include the Company Secretary and the CFO. The term ‘relative’ is extended to include all lineal ascendants or descendants, related by marriage or adoption. Further, it requires increased disclosures for related party transactions. The Bill has also introduced the concept of ‘associate company’ i.e., a company in which another company has 26 per cent or more voting power or ability to control business decisions by virtue of an agreement. Further, the proposed ceiling of tenure for Independent Directors is six years while Clause, 49 prescribes a term of nine years. On the lines of Clause 49, the MCA Voluntary Guidelines on Corporate Governance, 2009 recommends a maximum tenure of six years.

After the global financial meltdown in 2008-09, the SEBI has attempted to deal with the issue of companies’ solvency in a number of ways. For instance, it is proposed that for entities which submit annual audited results in lieu of last quarter’s unaudited financial results with limited review, audited annual results on stand-alone as well as consolidated basis shall be disclosed within 60 days, instead of 90 days at present, from
the end of the financial year. Further, companies will now have to disclose their asset-liability and solvency positions, at specified intervals. The regulator has also determined that limited review and statutory audit reports will be furnished only by those auditors who have undergone peer review process of ICAI and hold a certificate given by the Peer Review Board to enhance the quality of audit.

On a different front, the SEBI has made it mandatory for companies to submit an auditors’ certificate at the time of seeking approval for the scheme of amalgamation, mergers and reconstruction to establish that the accounting treatment is in accordance with the Accounting Standards. Moreover, listed entities with subsidiaries have been given the choice to submit their consolidated financial results as per International Financial Reporting Standards.

The new Companies Act will make internal audit mandatory.²⁸ The internal auditor shall be either a Chartered Accountant or a Cost Accountant. The Voluntary Code of Corporate Governance issued by the MCA in the year 2009 stipulates that the internal auditor should not be an employee of the company. Reading together the above two provisions, it may be concluded that in coming years, the practice of outsourcing of internal audit function will gain momentum. Internal audit covers audit of operations, audit of internal and external information system, audit of risk management system and also audit of management decisions.

Perhaps, the PSCF wants the Companies Bill to include provisions of CG rather than leave such regulations of listed companies to SEBI.²⁹ In doing so, instead of taking a hard look at the CG mechanisms administered by SEBI, the PSCF has simply sought to
adopt whatever SEBI has recommended. Worse, the MCA is now being given a greater say under company law on defining the role of Independent Directors - a provision in the Companies Bill will state that the role, duties and functions of Independent Directors shall be such as may be prescribed by the Central Government. Therefore, this is one of the 235 areas in which the MCA has been given powers to be ‘prescriptive’ on the role of Independent Directors. The PSCF wants the MCA to do more in this area. Curiously, SEBI and the RBI were heard by the PSCF about the need to avoid regulatory overlap.

It has been pointed out that provisions of Companies Bill, 2009 are even stricter than those contained in Clause 49 of SEBI’s Listing Agreement. Some voluntary provisions have been accommodated in the proposed law.\(^{30}\)

Besides the Listing Agreement of SEBI, certain provisions of the Companies Act 1956 and Companies Bill 2009 should be complementary to Clause 49 of the Listing Agreement.\(^{31}\)

3.2 CG in Operation

Good CG requires that a company incorporate such elements as Clause 49 of Listing Agreement into its operational fabric.\(^{32}\) While most listed Indian companies have not reaped the benefits of true CG, several high-performance organizations have implemented initiatives that are noteworthy.

At a seminar on Board leadership, directors belonging to medium-sized companies were surveyed about their understanding of CG.\(^{33}\) It was found that CG was interpreted variedly. Less than half thought that CG meant leadership; several felt Clause
49 to be an imposition by the SEBI while several others candidly stated their belief that business is all about money, control and power (Exhibit 3.5).

EXHIBIT 3.5
RESPONSE OF DIRECTORS AND SENIOR MANAGERS TO WHAT THEY THOUGHT CG MEANT


In a similar attempt, a survey was carried out among over 30 CFOs from diverse sectors. They were asked to assign weights to corporate functions corresponding to the importance of such corporate functions in the management of companies (Exhibit 3.6).
EXHIBIT 3.6

PERCENTAGES OF RESPONDENTS (CHIEF FINANCIAL OFFICERS) RANKING CORPORATE FUNCTIONS

<table>
<thead>
<tr>
<th>Corporate Functions</th>
<th>Weights*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Governance</td>
<td>33</td>
</tr>
<tr>
<td>Functional Roles</td>
<td>19</td>
</tr>
<tr>
<td>Management Information System</td>
<td>15</td>
</tr>
<tr>
<td>Treasury and Risk Management</td>
<td>11</td>
</tr>
<tr>
<td>Investor Relations</td>
<td>11</td>
</tr>
<tr>
<td>Others</td>
<td>11</td>
</tr>
<tr>
<td>Capital Structure</td>
<td>07</td>
</tr>
<tr>
<td>Mergers &amp; Acquisitions</td>
<td>07</td>
</tr>
</tbody>
</table>

*Weights by respondents don’t add up to 100 per cent since some respondents’ ranked more than one area as most important.


The data appearing in Exhibit 3.6 are presented in Figure 3.1 below.

FIGURE 3.1

CG: Top of the Agenda
Apart from CG being an important function for companies, it enables the company to align its own interests with that of stakeholders. While government intervention has certainly increased the level of CG awareness among Board members and executives, it has unfortunately not extinguished corporate frauds.\textsuperscript{34} Although technology companies and other companies have focused on revisiting and updating Board-level policies and procedures by implementing the revised Clause 49 of the Listing Agreement, this continues to be a mechanical, “tick-the-box” exercise for many companies. The best example in India can be Satyam Computers; an award-winning company for CG which turned out to be a shocker (Exhibit 3.7). The focus of most organizations has been on achieving legal compliance, for instance, introducing the appropriate mix of Executive and Non-Executive Directors on their Boards. But beyond this, not much has been done. Most listed companies continue to view CG as a compliance-driven exercise i.e., an effort to ensure that they implement the “minimum required” that can keep them out of legal implications such as penalties.

A study entitled “Early Warning Signals of Corporate Frauds” conducted by the Pune - based India Forensic Consultancy Services, a forensic accounting and education firm, from January to August, 2008 has brought out shocking revelations about corporate frauds.\textsuperscript{35} According to the study, at least 1,200 companies out of 4,867 companies listed on the BSE and 1,288 companies listed on the National Stock Exchange as on 31\textsuperscript{st} March 2007, including 25-30 companies in the benchmark Sensex and Nifty indices have manipulated their financial statements. The motive for committing accounting statement frauds, according to 73 per cent of 340 Chartered Accountants, who were respondents, was to surpass expectations of the stock market. Other reasons for the fraud include the
manipulation of data by unscrupulous firms in applications for bank credit, in order to avail finance. Even with all the in-built checks and balances and the oversight of the working of companies across India by the DCA and other arms of the government, it is baffling that about 20 per cent of listed companies produced financial statements that were fraudulent.

EXHIBIT 3.7

HALL OF SHAME IN INDIA

<table>
<thead>
<tr>
<th>Company / Scandal</th>
<th>Details in Brief</th>
</tr>
</thead>
</table>
| Securities Scam (1992) by Harshad Mehta    | Some banks were involved and the stock market nosedived, after a meteoric rise.  
   1                                                                                     |
   3,911 companies which raised over Rs. 25,000 Crore vanished or did not set up their projects. |
| Plantation Companies (1995–96)            | About Rs. 50,000 Crore were mopped up from gullible investors seeking higher returns from plantation companies and the companies vanished. |
| Non–banking Finance Companies Scam (1995–97)| About Rs. 50,000 Crore were raised from investors seeking higher returns; companies vanished. |
| Global Trust Bank (2002–03)               | Audited accounts showed profit of Rs. 40 Crore while RBI Report revealed negative net worth. Then the bank was forced to merge with Oriental Bank of Commerce. It was a case of mismanagement of bank assets for personal gains by top officials, fraudulent financial reporting and audit failure (Rs. 13,000 Crore were involved). |
| Satyam Computers Fraud (2008–09)         | Fudged the company’s accounts to the tune of Rs. 7,200 Crore.  
   2                                                                                     |

Sources:  
The capital markets regulator, SEBI was preparing to take action against five public sector undertakings for non-compliance with Clause 49.\textsuperscript{36} Reportedly, the stock exchanges sent a list of nearly 20 Public Sector Units (PSUs), which included some of the \textit{Navratnas} for not complying with Clause 49. In an unexpected move, SEBI initiated adjudication proceedings for the first time against 20 companies, including five PSUs. While the companies’ identities were not revealed, the action against the PSUs has been on the issue of non-compliance with provisions relating to Board composition.

Earlier, various PSUs had been served show-cause notices from SEBI for non-compliance with Clause 49.\textsuperscript{37} One reason for the delay in the follow-on public offer of Steel Authority of India Limited was that it did not have an adequate number of Independent Directors. The company had just four Independent Directors against the required twelve. Earlier the public offer of another company, viz., National Hydropower Corporation was delayed by several months on the same grounds.

Some years ago, BSE came down harshly on 52 companies, threatening to suspend trading in their stocks from September 20, 2006 for non-compliance with listing norms.\textsuperscript{38} However, the exchange gave an opportunity to the companies to mitigate the punishment. If the companies complied with the listing norms prior to the date of suspension, then the companies would be suspended for only five trading days till September 26, 2006.

In 2007, the BSE served show cause notices to about 800 companies for infractions of the Listing Agreement, that also includes CG norms.\textsuperscript{39} For violating the norms the exchange recommended to SEBI to take action against companies as the
exchange did not have the authority to impose penalty. According to the BSE, 1,213 companies had not submitted the CG compliance report for the period ended March 2008.\textsuperscript{40} That works out nearly to one fourth of 4,895 companies listed on the BSE which need to establish that they are abiding by CG norms. Many of 1,213 companies were in the Z group of the BSE, notable for thin trading and dubious dealings which do not even have a proper Board.\textsuperscript{41} Most of them were listed in the 1990s, when listing norms were deficient and unscrupulous promoters raised money for doubtful projects.

3.3 CG – Implementation

Judicious enforcement helps to maintain the overall credibility of a regulatory system. But, zealous enforcement is not always desirable. It can dampen valuable risk-taking abilities of firms. Unlike traditional Boards, enlightened Boards do not feel constrained by the rules and regulations, say, compliance with Clause 49 of the Listing Agreement in India or SOX Act, 2002 in US.\textsuperscript{42} They do not need Clause 49 of the Listing Agreement or SOX Act to preserve values and ethics or monitor their CEO’s performance. Unlike the typical Board that will focus on complying with regulations, enlightened Boards deem compliance with regulations as merely a minimum threshold for Board performance.\textsuperscript{43} Enlightened Boards regard their mission as providing supportive assistance to management in leading the company. Enlightened directors strongly believe that it is their responsibility to engage in an intellectual exercise of charting the company’s future path. CG, and its implementation in India, is not only being seen as a sequel to recent corporate frauds, but also as a corollary to the strong
emergence of the Indian economy. With greater global integration, Indian companies appreciate the need to be robust, ethical and transparent in their operations.

3.3.1 SCHEDULE OF IMPLEMENTATION OF CLAUSE 49 OF THE LISTING AGREEMENT RECOMMENDED BY THE KUMAR MANGALAM BIRLA COMMITTEE

The committee recognized that compliance with its recommendations would entail restructuring the existing Boards of companies. It also recognized that some companies, particularly the smaller ones, may experience difficulty in immediately complying with these conditions. The Committee recommended that while its recommendations should be applicable to all the listed companies or entities, there is a need for phasing the implementation as follows.

i) By all entities seeking listing for the first time, at the time of listing.

ii) During the financial year 2000-2001, but not later than March 31, 2001 by all entities, which are included either in Group ‘A’ of the BSE or in Standard and Poor’s (S&P) CNX Nifty Index as on January 1, 2000. However to comply with the recommendations, these companies may have to initiate the process of implementation as early as possible. These companies would cover more than 80 per cent of the market capitalization.

iii) Within the financial year 2001-2002, but not later than March 31, 2002 by all the entities which are presently listed, with paid up share capital of Rs. 10 Crore and above, or net worth of Rs 25 Crore or above any time in the history of the company.
iv) Within the financial year 2002-2003, but not later than March 31, 2003 by all the entities which are presently listed, with a paid-up share capital of Rs 3 Crore and above. This was a mandatory recommendation of the said committee.

Clause 49 of the Listing Agreement for CG in February 2000 has been amended several times. It was amended twice in 2000, thrice in 2001 and again in 2003. Further, Clause 49 amended on 29th October, 2004 contained major changes with regard to (1) definition of Independent Directors; (2) strengthening the responsibilities of Audit Committees; (3) improving the quality of financial disclosures including those pertaining to related party transactions and proceeds from public/rights/preferential issues, and (4) requiring Boards to formally adopt a code of conduct; (5) requiring CEO/CFO certification of financial statements and for improving disclosures to shareholders. Also included are some non-mandatory clauses like whistle-blower policy and restriction of the term of Independent Directors. After notifying Clause 49 of the Listing Agreement in 2004, SEBI declared that it was to come into effect from April 1, 2005. However, since SEBI was apprised that large companies were still not geared to adhere to such a clause, its implementation was further deferred. Thus revised Clause 49 came into effect from January 1, 2006.

It has been pointed out that the true value of CG goes beyond just ensuring compliance with regulations. In fact, India’s policy makers, through the framework of the revised Clause 49, require companies to assess and manage the total risks. While these practices do not guarantee that fraud will not occur, they do provide reasonable assurance that the interests of a company’s stakeholders will be protected by the management on a
proactive basis. This is the true spirit of risk management and good CG - one that India Inc. needs to embrace as it continues gain prominence on the global business stage.

One view is that faster growing firms are more likely to raise equity capital and may benefit more from the commitment to good CG prescribed by Clause 49. Cross-listed firms may attract more investment by foreign investors inclined to CG. The positive reception to Clause 49 contrasts with the negative reaction to the SOX Act, 2002 in US. Some legal scholars have argued that SOX Act is tantamount to regulatory over-kill (e.g., Ribstein, Romano). Interestingly, though a number of key elements of Clause 49 are comparable to SOX Act, 2002.

3.3.2 PRESENT SCHEDULE OF IMPLEMENTATION OF CLAUSE 49 OF LISTING AGREEMENT

The provisions of the revised Clause 49 shall be implemented as per the schedule of implementation given below.

a) For entities seeking listing for the first time, at the time of seeking in-principle approval for such listing.

b) For existing listed entities which were required to comply with Clause 49 which is being revised i.e., those having a paid up share capital of Rs. 3 Crore and above or net worth of Rs. 25 Crore or more at any time in the history of the company, by April 1, 2005.

*Include public sector units and body corporate i.e. private and public sector banks, financial institutions, insurance companies and exclude mutual funds. Source: FAQs on Corporate Governance, January 2006, available at www.nseindia.com
3.3.3 BARRIERS TO CG REFORMS

Despite considerable reforms for furtherance of CG in India, there still are barriers, as described below.

3.3.3.1 Varying Provisions of CG by SEBI and MCA.

It has been pointed out that the SEBI and government have overstepped in their enthusiasm to coax corporations into adopting CG practices, resulting in overlapping of mandatory regulations.\textsuperscript{53} Further, in India, besides SEBI, MCA has also appointed committees on CG and has amended the voluminous Companies Act, 1956 in the year 2000. These amendments have resulted in a codification of CG practices, which differ from that of SEBI. For example, company law does not require shareholders’ approval for related party transactions whereas SEBI is empowered to issue appropriate directions in order to secure the best interests of investors.\textsuperscript{54} The inconsistency in the codified practices has triggered confusion among corporations and it only emphasizes the need to have only one authority to frame CG practices.

3.3.3.2 Frequent Amendments to CG Norms. Frequent amendments to CG norms can interfere with effective implementation of CG. It is not good to come out with changes in CG provisions after every corporate fraud whether such fraud is in India or elsewhere.

3.3.3.3 Lack of Board Independence in Family-Controlled Companies. In a survey, Moody’s and ICRA Limited have observed that family-controlled companies globally are characterized by specific CG deficiencies.\textsuperscript{55} These include: (i) comparatively fewer checks and balances on their actions (ii) leadership transition risks, and the emergence of
conflicting visions and strategies (iii) limited transparency on matters such as ownership, control and related party transactions (iv) slowness to adapt, or respond to emerging business challenges (v) propensity towards higher leverage. The Indian corporate sector is dominated by companies controlled and run by family groups. For instance, 17 of the 30 Sensex companies are family-controlled. A lack of clarity on ownership and the financial position of unlisted family-controlled holding companies (with significant debt in their capital structure to fund the group) pose financial risks. This is a symptom of an anxiety to try avoid losing control while the families pursue their aggressive growth plans. Despite regulations aimed at an independent Board of Directors, the families retain significant control over listed companies - and sometimes seem to be acting mainly to benefit their group or themselves. Therefore, the difficulty in fathoming the true independence of directors is a big CG challenge.

3.3.3.4 Absence of Fully-Consolidated Financial Accounts. Companies listed on stock exchanges need to prepare consolidated financial statements in compliance with the Listing Agreement as per SEBI. However, such a consolidation does not present a true picture of firms. If the parent company which is controlled by a family is not listed, vital information to stakeholders is not available. Sometimes a listed subsidiary may have no

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* The Sensex is the common name for the Bombay Stock Exchange Sensitive Index, comprising the 30 largest and most actively traded stocks.

* Interestingly, dual classes of shares may emerge in future cases where companies issue convertible bonds, but want to avoid dilution of family control should conversion occur. Both Tata Motors and Tata Steel have recently issued Convertible Alternate Reference Securities that are intended to convert into shares with different voting rights from equity shares.
debt, but it is possible that its unlisted holding company might be highly leveraged. So based on publicly available information, it may not be easy to carry out a thorough financial analysis of the group by investors and stakeholders.

3.3.3.5 **Inappropriate Size of Boards.** According to Moody’s opinion, for medium and large companies, the appropriate Board size is usually eight to twelve. Board size should be balanced because if Board size is small then it is hard to have adequate representations of members on required committees and the prospects of deliberations get reduced; conversely with a large, unwieldy Board, co-ordination in Board meetings becomes an uphill task. The Board size is recommended at between 6 and 8 directors by Jensen, about 8 to 9 by Lipton and Lorsch and 6 directors by Garg.

3.3.3.6 **Weak Boards.** Several Indian companies including listed ones, are large and family owned. In a survey involving a sample of 32 Indian companies run by 16 family-controlled business groups it was ascertained that in only about 25 per cent of the companies was the role of CEO and Chairman separated. Additionally, in the sub-set, the chairman was either a former CEO or a nominee of the controlling family. These statistics highlight the dimension of anaemic Boards. About 67 per cent of the companies were having a family-linked person as Chairman and CEO. There was no presence of an independent professional Chairman and CEO in any of the companies.

One view is that in practice, companies apparently do not prefer a monitoring Board of Directors. The executive management would prefer a passively advisory Board, rather than one which scrutinizes them. CG should not result in too many controls so as to threaten managerial entrepreneurship and innovation. The consequence would be
to diminish the actual and expected gains to shareholders.

Enhanced financial disclosures reduce information asymmetry and probability of earnings management which in turn can facilitate monitoring by stakeholders. In this regard, the role of Audit Committee is vital. It should be made accountable for non-compliance of accounting aspects and practices of earnings management if any.*

According to a study, over seven of the 10 Independent Directors on the Boards of listed companies are members of the controlling family.62 Nearly 75 per cent of all Independent Directors are family members aligned with the promoters and so are not independent, as per the study by the research firm Prime Database, which administers the website, directorsdatabase.com, a joint initiative with the BSE. Even if the family members - who include relatives, friends and neighbours are qualified, they cannot presumably act independently because of their links with the promoters, added the study which looked at the profiles of Independent Directors. The study further points out that very few women are Independent Directors i.e., about 2.5 per cent of the 6,443 functionaries engaged by listed companies. Further, the report mentions that only 15 per cent of the Independent Directors on the listed companies are capable of making effective contributions in Board meetings. These include lawyers, finance professionals and technocrats. The Prime Database study also added that 48 per cent of Independent Directors are above 60, while a few of them are in their nineties! The advanced age itself gives rise to certain concerns about their capabilities. Moreover, while 245 Independent Directors are below 35 years, as many as 20 are under 25 years of age.

* Earnings management means fictitious disclosures of earnings in the interest of management of company.
A concern expressed on the move to appoint former bureaucrats as Independent Directors is that it may constrict the autonomy of PSUs in long run. As such officials have been associated with government it may be difficult for them to express independent views. According to current practice, administrative ministries indirectly control such appointments in PSUs.

3.3.3.7 Unsatisfactory Performance of Independent Directors. An assertion that has been made is that Independent Directors have so far failed to perform their monitoring role effectively. The reason offered is that ‘Board independence’ is an idea that has just emerged in India and is gaining currency. Further, another reason is that the talent pool of Independent Directors is limited. It was observed that the cross-directorship phenomenon was also prevalent. In such cases, their effectiveness and independence have been doubted. CG has not yet considered the ‘cross-directorship’ phenomenon while defining the criteria for appointment as an Independent Director.

Boards are required to have a majority of non-executive or “outside” directors as per the listing norms of several stock exchanges. Bringing about Board reforms does not guarantee active involvement by members in Board meetings. Better CG regulatory measures may help to define Board structure and composition but accountability and responsibility are of individual members. Effective CG can be fostered when there are sincere deliberations and candid discussions in Board meetings coupled with free exchange of information between the management and Board members. If companies understand the importance of good CG and regulators play their role then the quality of CG may improve. The following quote of Professor Sonnenfeld drives home the point:
“We will be fighting the wrong war if we tighten the procedural rules for Boards and ignore their pressing need - to be strong high functioning work groups whose members trust and challenge one another and engage directly with senior managers on critical issues facing corporations.”

The twin roles of Independent Directors are to monitor the executive management; and to add value in Board meetings. The case of Satyam, however, is apparently regarded as an instance of dereliction of responsibility by Independent Directors, according to the Standing Committee relating to The Companies Bill, 2009. The failure of Satyam is a failure of Independent Directors and many Experts endorse this view. But, it is also conceded that Independent Directors performed the second role effectively and that is the why Satyam could be brought back on track so fast. Usually, in Board meetings during a disagreement among Board members, the majority view prevails, therefore, if the proportion of Independent Directors stays at one-third, then a company can get any agenda item approved by the Board. Independent Directors will not be able to thwart decisions which they regard as undesirable for shareholders; at best they can only register dissenting views. Most Independent Directors would be wary of being branded as dissenters, so one may not hear of frequent dissents in the Board room. Therefore, Independent Directors may be unable to do justice to their monitoring role, unless a whistle-blowing mechanism is put in place. Although there is forward movement on introducing such a provision, it remains to be seen as to whether the mechanism will be used well. The MCA has also agreed that no individual shall have more than two tenures as Independent Director in any company. The limit is conceived on the assumption that
closeness to the executive management will corrupt their independence.

3.3.3.8 Negligence by Independent Directors. Questions arose again on the role of Independent Directors serving the Boards of public sector banks and other state-run entities following the arrest of M. S. Johar, a Chartered Accountant who was a director on the Board of Central Bank of India. Satyam Computers was an earlier instance; further, other companies vanished with shareholders money. So Independent Directors have been lax and have allowed companies to indulge in unfair practices to some extent. The new Company’s Bill, is expected to inject reforms and clean up the appointment process of Independent Directors. It is also expected to determine responsibility of these directors so that they perform the role expected of them.

Apparently, the Board of Directors have fallen short in their monitoring responsibility. The reasons are, though, directors are to be appointed by shareholders, in practice the management makes these appointments. Further, the directors so appointed and having rich and varied expertise, may not succeed in improving CG. These are instances of CG failures in companies which have had reputed members on their Boards despite having Audit Committees responsible for managing risk. But, sincere and committed Independent Directors in progressive companies can enhance performance.

3.3.3.9 Paucity of Independent Directors. As per data compiled by directorsdatabase.com, about 340 Independent Directors stepped down from various listed firms in 2009. They became hesitant about taking up responsibility as they felt unable to express dissenting views against the founders. The role of Independent Directors was highlighted when Satyam founder B. Ramalinga Raju made a $ 1.6 billion
bid to acquire a firm promoted by his relative. The deal angered investors and regulators questioned the role of Independent Directors. Till the Satyam scam, they served on the Boards of 4-5 companies with inadequate involvement in Board matters while collecting sitting fees. But after the scam they have turned cautious about accepting such positions. It has been pointed out by no less than the Secretary (Disinvestment), Sumit Bose that the absence of the required number of Independent Directors is a major obstacle in listing central public sector enterprises.\textsuperscript{71} Further, according to Housing Development Finance Corporation Chairman Deepak Parekh, there is a shortage of Independent Directors in Indian companies and further, if the government proceeds against them for industrial accidents or for lapses for which they are not directly accountable, then the directors would retreat from accepting such assignments.\textsuperscript{72} To alleviate the problem for Government companies, it is proposed to relax the stipulation of Independent Directors from 50 per cent to one-third of the Board size of the company.\textsuperscript{73}

The Chairman and Managing Director of Oil and Natural Gas Corporation (ONGC), also demanded that the proportion of Independent Directors on PSU Boards be reduced to one-third, since the Board becomes ‘too large to manage’ if Independent Directors are to constitute 50 per cent.\textsuperscript{74} According to SEBI guidelines, 50 per cent of the company’s Board should consist of Independent Directors and it does not recognize government nominee directors on the PSUs Board as Independent Directors. ONGC has not been able to meet the CG guidelines as the oil ministry has failed to approve the names of Independent Directors to be appointed on its Board for years.

3.3.3.10 Non-Evaluation of Board of Directors. The evaluation of the performance of Board of Directors is not a mandatory requirement as per Clause 49 of the Listing
Agreement. CG provisions alone cannot ensure transparency unless people are ethical in business conduct and are evaluated for work assigned to them.

3.3.3.11 Inadequate Attendance in the Board Meetings. Regular attendance by Independent Directors is expected in Board meetings. The absence of Independent Directors, on account of any reason, matters, as decisions taken by other Board members may not best serve the interest of stakeholders particularly equity shareholders.

3.3.3.12 Inadequate Participation in Board Meetings. The presence of Independent Directors will be useful if they do ask pertinent questions in the Board meetings. However, they may balk from doing so as it can jeopardize their relationship with other Board members and also, their stakes are minimal.

3.3.3.13 Ambiguity in Role and Responsibilities of Independent Directors. Former NASSCOM President, Kiran Karnik has expressed need for clarity on the legal liabilities of Independent Directors vis-à-vis Whole-Time Directors.²⁵ Similarly, former Chairman of Life Insurance Corporation of India S. B. Mathur said that Independent Directors ought not to be held responsible for any mishap in those companies where they serve on the Boards as they are not privy to day-to-day information and are dependent on executive management. They ought to be held accountable only if their negligence can be established.

3.3.3.14 Unremunerative Sitting Fees or Compensation. If compensation is too high, Independent Directors may refrain from asking probing questions or from dissenting on any decision taken by the Board as they may fear losing the Board position. On the other hand if it is too low, they may not bother much, as such compensation is too little to
motivate regular attendance and participation in Board meetings. Moreover, establishment of the Remuneration Committee is not a mandatory requirement as per Clause 49 of the Listing Agreement. So, to decide suitable remuneration becomes a tricky matter. For instance, it is tantamount to expropriation if remuneration is decided by nepotism. This can take place in the absence of a Remuneration Committee as it is left to one person’s discretion to decide.

3.3.3.15 Deficient Performance of Auditors. According to Mehta, a managing partner of a firm, several lessons emerge from the Satyam debacle, some of which are as follows: (a) the Audit Committee need to be more efficient and accountable; (b) persuade the auditors to place more reliance on direct external audit evidence; (c) mandatory mechanism of whistle-blower policy for companies. He further says that effective Joint-audit and quality review of audit firms by ICAI seems very desirable. Further, there is increased need to establish the independence of auditors according to Sugata Sircar, Chairman – CII’s CFO Forum 2009 and Finance Director, Gujarat Gas Company Limited. CII has suggested to ICAI to standardize disclaimers given by the auditors.

Recognizing the existing deficiencies perhaps, a new set of Accounting Standards (International Financial Reporting Standards) is expected to improve CG by increasing disclosure standards. Similarly, on January 7, 2011 the Financial Reporting Council of UK has issued a discussion paper entitled ‘Effective Company Stewardship – Enhancing Corporate Reporting and Audit’.

3.3.3.16 Rotation of Audit Partner or Audit Firm. An important question is whether to rotate the audit partner or audit firm to improve the quality of audit. One possibility is the
rotation of an audit partner.\textsuperscript{80} Another option is the rotation of audit firms. However, the options for companies are limited to the big four international firms and a handful of Indian firms. Concerns have been expressed that mandatory rotation of audit firms may impair audit quality.\textsuperscript{81} Further, the experience of some countries such as Austria, Canada and France have prompted them to discard the idea of rotation of audit firms, while retaining the idea of rotation of partners.\textsuperscript{82} Studies in Europe reveal that auditor rotation had resulted in the erasure of past cumulative knowledge.

3.3.3.17 The Costs of Rotating Audit Partners or Audit Firm.

Only a few recognized audit firms or audit partners are available as mentioned above. Medium-sized companies may find it difficult to hire them, as they may charge hefty audit fees.\textsuperscript{83} Moreover, recognition of audit firms or partners now requires approval by the Peer Review Board, so the availability of audit firms or partners will remain limited.

3.3.3.18 Possibility of Defaults in Joint Audit. Internationally, each joint auditor is responsible for the entire balance sheet but under Indian Standards, each joint auditor responsibility is limited to the work done by him.\textsuperscript{84} A person perusing a balance sheet cannot make the distinctions and in a complex situation grey areas and issues could easily complicate the efforts to determine accountability.

3.3.3.19 Efficacy of Audit Committee Meetings. It has been asserted that the frequency of Audit Committee meetings has an important impact on the internal control and evaluation function of a company.\textsuperscript{85} More meetings tend to improve this function as judgment and time is required in the evaluation of this function.
3.3.3.20 **Inferior Quality of Audit.** Under the Companies Auditor’s Report Order of 2003, the auditor has to report on whether the company has an internal audit system commensurate with the size and nature of business. Thus, a system that reviews the work of the internal auditor is already in place. According to Bhattacharyya it is apparent that the internal control system has not worked well. He stresses that effective enforcement of extant laws can produce desired results rather than seeking to make new laws. Clause 49 mandates the Audit Committee to review the internal audit reports and to ascertain internal control weaknesses if any apart from the appointment, removal, and remuneration of the Chief Internal Auditor. The Audit Committee is responsible for good audit practices to fortify internal control. But, the performance of the Audit Committee has been deficient thereby impairing audit quality. Therefore, Bhattacharyya believes an agency independent of the ICAI to review the auditors is one possibility in this regard.

3.3.3.21 **Absence of Board Oversight of Audit.** India does not have any independent oversight Board which is necessary for India to be treated at par with other developed countries. The oversight board is an European Union (EU) requirement and it will impact Indian auditors whose companies are listed at EU exchanges. Incidentally, India boasts of firms which audit more than 200 companies listed at various EU Exchanges. Therefore as pointed out by Rahul Roy, an independent oversight body when formed could seek membership of the International Forum of Independent Audit Regulators, thus internationally integrating the Indian profession.

3.3.3.22 **Flawed Design of Remuneration and Incentives Package.** Kar believes that it is desirable to have a Compensation or Remuneration Committee to draw up remuneration packages. The committee is to be accountable to the Board. For this the Board can set
compensation criteria in consultation with the committee. At the same time, companies should be transparent to shareholders in these matters.

3.3.3.23 **Principal-Agent Conflict.** Eun and Resnick point out that increasing managerial ownership may lift the firm value initially since the interests of managers and owners become better aligned. But if managerial ownership exceeds a certain point, the firm value may actually begin to decline as managers with larger shareholdings may effectively thwart takeover bids and can appropriate disproportionately larger benefits at the cost of outside investors. However, if the managerial ownership stake keeps on increasing then the alignment effect may become dominant again. As managers become larger shareholders it does not make sense to exploit themselves.

3.3.3.24 **Constraints on Proxy-Voting.** Bhattacharyya points out that a proxy cannot participate in discussions at General Meetings and can vote only in a poll. According to prevailing corporate practice, voting is done by a show of hands unless a poll is demanded. Therefore in most situations a proxy is unable to exercise the voting right.

3.3.3.25 **Lack of Investor Protection.** In the case of Optionally Fully Convertible Debentures (OFCDs) of two Sahara group companies, SEBI declared that it would not be able to provide redress to any investor on any complaint involving the instruments. The reason offered was that the OFCDs issued by these companies had not been done in compliance with the Companies Act, 1956 and the SEBI norms relating to public issues.

3.3.3.26 **Lack of Provisions for Class-Action Suits.** Class-Action Suits (CAS) allow shareholders to sue on a violation of any provision of a company’s Memorandum or Articles. Such suits can render void a resolution altering the Memorandum or Articles if
passed by concealment of material facts.\textsuperscript{92} CAS provide for restraining a company and its directors from proceeding on such a malafide resolution. These suits discourage a company from committing any act contrary to provisions of the law. Presently there is no such right available to shareholders but it is included in the Companies Bill, 2009 (and its updated versions up to 2011) which is yet to be approved.

3.3.3.27 Inadequate and Delayed Legal Mechanisms. Under the Companies Act, the powers and duties of directors are laid out in various sections such as 291, 297, 299, 397, 398, 408 and 629A. They emphasize directors’ fiduciary duties to shareholders, to act with due care, skill and good faith.\textsuperscript{93} Unfortunately the Act does not offer a proper remedial mechanism, providing for cancellation of unscrupulous transactions, compensation for corporate and stakeholder losses, recovery of ill-gotten gains, etc.

In the wake of globalization and increased competition in India, there is a need for institutional support to improve the legal system and law enforcement. The score for Rule of Law Index in case of India stood at 4.17 in 1998 which was significantly inferior to the English-origin average countries i.e., 6.46.\textsuperscript{94} Contract enforcement through courts of law is also a long-drawn process in India. Moreover, courts in India assign priority to criminal cases over civil cases. So there are further delays in the resolution of business disputes. An unfortunate feature of the Indian court system is the inordinate delay in court proceedings, which typically could take up to 20 years.\textsuperscript{95} In addition to this, the number of judges per Million citizens is slightly over 10 in India, which is significantly lesser than other countries; for instance, in the case of US it is 107 and in Britain it is over 50.\textsuperscript{96} Lack of alternative options of dispute resolution and paucity of judges drags disputes for several years. Hence, this imposes serious constraints on the Indian judicial system.
3.3.3.28 **Tunnelling.** Tunnelling seems to be widespread mostly via the non-operating components of profits. Market prices do not seem to incorporate tunneling; for example, on January 7, 2009 when the Satyam fraud was revealed, 9 out of 50 Nifty stock prices suddenly fell by more than 10 per cent, the median price decline of nine stocks was 15 per cent and the Nifty Index fell by 6 per cent. By the end of February, Nifty had fallen by 11 per cent and the median price decline of nine stocks was 37 per cent. However, at least one research study offers a somewhat different view.

3.3.3.29 **Free Rider Problem.** Institutional investors are prone to intervene in the CG of the company and while doing so they have to bear the cost of intervention in order to protect their interests. In this process, minority shareholders will ride free at the cost of institutional investors. Under such a situation, if, at all, they prefer to exit the company by selling their equity shares instead of intervening, it will not promote good CG.

3.3.3.30 **Passive Role of Institutional Investors.** Studies reveal that institutional investors in India have played an inert role in the CG system of Indian companies.

3.3.3.31 **The Hazard of Accounting Legerdemain.** It has been pointed out that Brand Value and Goodwill Accounting are areas in which calculations can be treacherous. Brand Value is an intangible asset that represents a premium ascribed to a company by virtue of its brand and reputation. One may compute a value utilizing a standard model based on free cash flow, profits before interest and taxes and sales projections. Yet, Brand Value goes beyond that. It is generally accepted that trust and consistency, are the foundations of Brand Equity, created by a sound ethos of dedication to customers, in terms of quality, service and so on, rather than by glib talk and impression management.
However, there are financial conmen who cast aside common sense and concoct misleading numbers of brand value of a relatively young enterprise on the basis of financial projections of the ensuing 10 years. This is what Jeff Skilling of Enron termed “hypothetical future value accounting” and convinced Wall Street analysts about it. Attractive valuations, though based on shaky grounds entice investors, especially when alternative investment avenues are scarce. When enterprises fail, Board members are known to have sought shelter under the excuse that the matter was not brought before the Board and so they were unaware.

In case, dummy revenues are recorded from the (fictitious) sale of goods or services, it will result in inflated profits. Another possibility is by debiting dummy expenditure in the books of accounts and simultaneously misappropriating an equal amount of cash. Another concern is that window dressing and secret reserves are possible even within the framework of Accounting Standards. For instance, with Depreciation Accounting, Accounting Standard-6 allows a change in the method of depreciation, and a differing amount of depreciation will either increase or decrease profits. Hence by a change in the method of depreciation, accounts can be falsified. In short, accounting legerdemain is an important concern of CG.

3.3.3.32 Recurring Insider Trading. On March 11, 2011 the SEBI barred three Independent Directors of Pyramid Saimira from sitting on the Board of any listed company for two years for giving false and misleading statements. Such problems could be linked to the lucrative remuneration associated with Independent Directorships; each Board meeting can yield up to Rs. 20,000 for a director. The law permits one per cent of the profit to be distributed amongst the Independent Directors, and there is no
restriction on the stock options that can be offered. According to Prithvi Haldea of Prime Database a retired bureaucrat earned Rs. 2.2 Crore in 2007-08 from his directorships in ten listed companies and two foreign companies. His income from four unlisted companies was extra. In all probability, promoters would not prefer strangers on the Board, and Independent Directors may often be happy to be acquiescent.

A view that has been expressed is that the work of the market regulator and auditors cannot be assigned to Independent Directors. The question posed is whether they have the tools and the expertise to detect frauds. Satyam is a good example of how even Independent Directors were lax. The Independent Directors on its Board were criticized because they had no clue of Raju’s misdeeds practiced over seven long years. Subsequent to the scam, over 2,000 Independent Directors have reportedly resigned which is not a good sign.

3.3.3.33 Corruption, and Incomplete or Delayed Investigation. Corruption prevalent in a country also affects enforcements of corporate regulations especially CG which advocates transparency and disclosures of business transactions in a country (Exhibit 3.8).
EXHIBIT 3.8
TRANSPARENCY INTERNATIONAL’S CORRUPTION INDEX RANKINGS

<table>
<thead>
<tr>
<th>Country</th>
<th>Corruption Perceptions Index (CPI) RANK</th>
<th>CPI SCORE</th>
</tr>
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<tbody>
<tr>
<td>Denmark</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Singapore</td>
<td>4</td>
<td>4</td>
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<tr>
<td>Australia</td>
<td>9</td>
<td>11</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>12</td>
<td>14</td>
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<tr>
<td>UK</td>
<td>16</td>
<td>12</td>
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<tr>
<td>Japan</td>
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<tr>
<td>US</td>
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<td>France</td>
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<td>19</td>
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<tr>
<td>South Korea</td>
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<td>43</td>
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<tr>
<td>South Africa</td>
<td>54</td>
<td>43</td>
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<tr>
<td>Mexico</td>
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<td>72</td>
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<tr>
<td>China</td>
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<td>72</td>
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<tr>
<td>Brazil</td>
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<td>72</td>
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<tr>
<td><strong>India</strong></td>
<td><strong>85</strong></td>
<td><strong>72</strong></td>
</tr>
<tr>
<td>Russia</td>
<td>147</td>
<td>143</td>
</tr>
</tbody>
</table>

Note: Ranks go from 1 to 180 with 1 being least corrupt and 180 being most corrupt. Scores go from 1 to 10 with 1 being most corrupt and 10 being least corrupt.


The Serious Fraud Investigation Office (SFIO) was set up under the MCA to, among other things, look into cases of substantial involvement of public interest in terms of the size of monetary misappropriation and persons affected. However, the agency appears to be ineffective in implementation. Incidentally, as pointed out, the SFIO, is not even a statutory body and so lacks powers of search and seizure and of interrogation. Even the documents seized from Satyam’s offices have not been shared with the SFIO.
3.3.3.34 Undesirable Consequences of Mandatory CSR. The MCA has been favouring a mandatory provision for every company having a turnover of Rs. 1,000 Crore or more, or a net worth of Rs. 500 Crore or more, or a net profit of Rs. 5 Crore in a year to spend at least 2 per cent of their average net profits during the three preceding financial years on CSR. If this provision is approved then the scope for corruption increases as the meaning of CSR can be widely applied. Further, many firms may manipulate profits on this account and even if they claim to have spent 2 per cent of such average profits on CSR, it cannot be verified unless it is audited. Firms are not happy with the proposal as a mandatory requirement since government intervention will increase, and shareholders’ interests will suffer.

3.3.3.35 Divergence in Emphasis among CG Models. Definitions of CG focus on interests of shareholders as well as on interests of stakeholders. The issue is that there is no commonly acceptable definition of CG among various countries. According to Allen and Gale, Anglo-Saxon countries viz., US and UK equate CG with firms pursuing the interests of shareholders whereas in countries like Japan, Germany and France, CG focuses on the interests of a wider set of stakeholders, including employees, customers and shareholders. Therefore, arriving at an objective definition of CG is itself a critical issue.

3.3.3.36 Sham Compliance. Debacles in the financial sector such as Satyam and other IPO related scams demonstrate that increased regulation has not improved the quality of CG. CG is being adhered to in letter but not in spirit.
Apart from the barriers stated above there are a few others such as insufficient guidance from authorities on CG enforcements, integrity of directors and auditors. For instance, it has been pointed out that in risk management framework and CEO/CFO certification of internal control evaluation, the lack of adequate guidance from regulators and other agencies has resulted in inconsistent implementation of CG. Moreover, many corporate frauds have been committed in companies having high-profile directors as well as in good companies having reputed audit firms.
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