Chapter-2
Codes of Corporate Governance

2.1 Introduction

Corporate Governance issues have attracted considerable attention, debate, and research world wide in recent decades. Almost invariably, such efforts gain momentum in the wake of some major financial scam or corporate failure, as these tend to highlight the need for tighter surveillance over corporate behaviour. Corporate governance has wide ramifications and extends beyond good corporate performance and financial propriety though these are no doubt essential. Therefore, in the present chapter we briefly discuss the major codes of corporate governance, i.e. Cadbury Report, the CII Code, the OECD Principles, the SEBI Code, and Sarbanes Oxley Act of 2002.

2.2 Cadbury Report

The Cadbury Committee submitted its report and associated "Code of Best Practices" in December 1992. The Code of Best Practices had 19 recommendations. Being a pioneering report on Corporate Governance, it would be in order to make a brief reference to them. The
recommendations are in the nature of guidelines relating to the Board of Directors, Non-Executive Directors, Executive Directors and those on Reporting and Control.

The recommendations are:-

1. The effectiveness of a board is buttressed by its regular meeting, full control over the company and check over the executive management.

2. The Chairman should be strong and independent rather than Yes Man. The responsibilities should be divided clearly.

3. Non-executive Directors should play a significant role in the board’s decisions. They should act as eyes and ears of the board. Therefore, the number of non-executive directors depends upon their caliber.

4. The Board should have a formal schedule of matters for decisions to ensure that the direction and control of the company is firmly in its hands.

5. If directors need advice for their duties then there should be a procedure of professional help, at the company’s expense.

6. The company secretary –
- should ensure that the company's multifarious activities are performed smoothly and conform to the provisions of law.

- should ensure the board that the board procedures are followed and applicable rules and regulations are complied with.

- should be appointed or dismissed by the board as a whole.

- should provide his professional advice to BODs.

7. Non-Executive Directors –

- should be independent.

- should be appointed through a formal procedure and their appointment should be specified.

- should not be re-appointed automatically.

- should bring an independent judgment on issues of strategy, performances, resources including key appointments and standards of conduct.

8. Directors' service contracts should not exceed three years without shareholders approval.

9. There should be full and clear disclosure of total emoluments, pensions and stock options for executive directors and
chairman. Separate figures should be given for salary and performance related elements and the basis on which performance is measured should be explained.

10. Executive directors’ pay should be subject to the recommendations of a Remuneration Committee made up wholly or mainly of Non-Executive Directors.

11. The main duty of the Board is to assess and present company’s actual position.

12. The Board and Auditors should maintain a good professional relationship.

13. The Board should establish an Audit Committee of at least 3 Non-executive Directors with written terms of reference, which deal clearly with its authority and duties.

14. The directors should explain their responsibilities for preparing the accounts next to a statement by the Auditors about their reporting responsibilities.

15. The effectiveness of the company’s system of internal control should be reported by the directors.
16. The Directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.

2.3 The CII Code

More than a year before the onset of the Asian crisis, CII set up a committee to examine corporate governance issues, and recommend a voluntary code of best practices. The committee was driven by the conviction that good corporate governance was essential for Indian companies to access domestic as well as global capital at competitive rates. The first draft of the code was prepared by April 1997, and the final document (Desirable Corporate Governance: A Code), was publicly released in April 1998. The code focuses on listed companies. As regards the rationale of the exercise, the committee pointed out that:

"since there is no unique structure of corporate governance, one cannot design a code of corporate governance for Indian companies just by mechanically importing one form or another. Moreover, Indian companies, banks and financial institutions (FIs) can no longer afford to ignore better corporate practices. As India gets integrated in the
world market, Indian as well as international investors will demand greater disclosure, more transparent explanation for major decisions and better shareholder value. The Committee further recognised that corporate governance goes far beyond company law. It pointed out that:

the objective of good corporate governance is maximising long-term shareholder value. Since shareholders are residual claimants, this objective follows from a premise that, in well performing capital and financial markets, whatever maximises shareholder value must necessarily maximise corporate prosperity, and best satisfy the claims of creditors, employees, shareholders and the State.

The Committee made the following key recommendations:

**Board of Directors**

- "The key to good corporate governance is a well functioning, informed board of directors. The board should have a core group of excellent, professionally acclaimed non-executive directors."

- "The full board should meet a minimum of six times a year, preferably at an interval of two months."
• "Any listed company with a turnover of Rs.1 billion and above should have professionally competent, independent, non-executive directors, who should constitute at least 30% of the board if the Chairman of the company is a non-executive director, or at least 50% of the board if the Chairman and Managing Director is the same person."

• "No single person should hold directorships in more than 10 listed companies."

• "To secure better effort from non-executive directors, companies should:
  • Pay a commission over and above the sitting fees for the use of the professional inputs.
  • Consider offering stock options, so as to relate rewards to performance."

• "While re-appointing members of the board, companies should give the attendance record of the concerned directors. If a director has not been present for 50% or more meetings, then this should be explicitly stated in the resolution that is put to vote. As a
general practice, one should not re-appoint any director who has not had the time to attend even one half of the meetings."

"Key information that must be reported to, and placed before, the board must contain:

- Annual operating plans and budgets, together with up-dated long term plans.
- Capital budgets, manpower and overhead budgets.
- Quarterly results for the company as a whole and its operating divisions or business segments.
- Internal audit reports, including cases of theft and dishonesty of a material nature.
- Show cause, demand and prosecution notices received from revenue authorities which are considered to be material important. (Material nature if any exposure that exceeds 1 percent of the company’s net worth).
- Fatal or serious accidents, dangerous occurrences, and any effluent or pollution problems.
- Default in payment of interest or non-payment of the principal on any public deposits, and/or to any secured creditor or financial institution.

- Defaults such as non-payment of inter-corporate deposits by or to the company, or material substantial non-payment for goods sold by the company.

- Any issue which involves possible public or product liability claims of a substantial nature, including any judgment or order which may have either passed structures on the conduct of the company, or taken an adverse view regarding another enterprise that can have negative implications for the company.

- Details of any joint venture or collaboration agreement.

- Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.

- Recruitment and remuneration of senior officers just below the board level, including appointment or removal of the Chief Financial Officer and the Company Secretary.

- Labour problems and their proposed solutions.
Quarterly details of foreign exchange exposure and the steps taken by management to limit the risks of adverse exchange rate movement, if material.”

"Listed companies with either a turnover of over Rs.1 billion or a paid-up capital of Rs.200 million should set up Audit Committees within two years. Audit Committees should consist of at least three members, all drawn from a company’s non-executive directors, who should have adequate knowledge of finance, accounts and basic elements of company law. Audit Committees should assist the board in fulfilling its functions relating to corporate accounting and reporting practices, financial and accounting controls, and financial statements and proposals that accompany the public issue of any security and thus provide effective supervision of the financial reporting process. They should periodically interact with the statutory auditors and the internal auditors to ascertain the quality and veracity of the company’s accounts as well as the capability of the auditors themselves.”
Desirable Disclosure

- "Listed companies should give data on: high and low monthly averages of share prices in a major stock exchange where the company is listed; greater detail on business segments, up to 10% of turnover, giving share in sales revenue, review of operations, analysis of markets and future prospects."

- "Major Indian stock exchanges should gradually insist upon a corporate governance compliance certificate, signed by the CEO and the CFO."

- "If any company goes to more than one credit rating agency, then it must divulge in the prospectus and issue document the rating of all the agencies that did such an exercise. These must be given in a tabular format that shows where the company stands relative to higher and lower ranking."

- "Companies which are making foreign debt issues cannot have two sets of disclosure norms: an exhaustive one for the foreigners, and a relatively minuscule one for Indian investors."
Companies that default on fixed deposits should not be permitted to accept further deposits and make inter-corporate loans or investments or declare dividends until the default is made good.”

The CII code is voluntary. Since 1998, CII has been trying induce companies to disclose much greater information about their boards. Consequently, annual reports of companies that abide by the code contain a chapter on corporate governance which discloses:

- The composition of the board: executive, non-executive and independent directors. An independent director is (i) not a formal executive and has no professional relationship with the company, (ii) not a large customer and/or vendor to the company, (iii) not a close relative of the promoter and/or any executive directors, (iv) not holding a significant stake, and (v) not a nominee of any large shareholder/creditor.

- The number of outside directorships held.
- Family relationship with other directors.
- Business relationship with the company, other than being a director.
- Loans and advances taken from the company.
• Remuneration – consisting of salaries and perquisites, sitting fees, commission and stock options, if any.

• Attendance of directors at board meetings, including those of special committees of the board.

These have to be tabulated as number of meetings held versus those attended.

In addition, companies are encouraged to disclose

• details about their monthly high and low share prices in various stock exchanges, and compare these with the market indices;

• data on the distribution of shares across various types of shareholders and according to size classes;

• complaints received from shareholders regarding share transfers, and how these have been addressed;

• economic value added (EVA), return on capital employed (ROCE) and return on net worth (RONW);

• details on risk factors, especially foreign exchange and derivative risks;

• details on contingent liabilities;
• data on outstanding warrants and their effect on dilution of equity, when converted;
• segment-wise information, wherever appropriate, in a chapter on management discussion and analysis.

The efforts have started to bear fruit. For the financial year ended 31 March 1999, 23 large listed companies accounting for 19% of India’s market caps have fully or partly adopted the CII disclosure norms. Indeed, companies, such as Infosys, have long overshot such norms. A more subtle, yet pronounced, effect of the CII initiative is a distinct trend among larger listed companies to look positively towards corporate governance, and to stop discounting it as ‘the favour of the month’.

2.4 The OECD Principles

To develop a set of corporate governance standards and guidelines, the OECD Council met at ministerial level on 27-28 April 1998. Consequently the OECD principles of corporate governance were framed and endorsed by the OECD Council in its meeting on 26-27 May 1999. The principles tries –

- to ensure the shareholders rights.
- to ensure the equitable treatment of all shareholders.
- to ensure the role of stakeholders
- to ensure that timely and accurate disclosure is made on all material matters regarding the Corporation, including the financial situation, performance, ownership and governance of the company.
- to ensure the strategic guidance of the company the effective monitoring of management by the board and the board’s accountability to the company and the shareholders.

The principles focus on publicly traded companies but they are applicable for non-traded companies also.

The main features of OECD principles are:-

1. Shareholders have the basic rights to secure the method of ownership. They can buy, sell or transfer the shares. They can obtain relevant information on the corporation on a timely and regular basis.

2. Shareholders have the basic rights to participate and vote in general shareholder meetings. Thus they should have the opportunity to fulfill these rights. They can vote by proxy (i.e.
telephonically or electronic voting or individually). They should consider the cost and benefits of exercising their voting rights.

3. Shareholders should be informed of the rules that govern general shareholder meeting like as –
   - Information about the date, location and agenda of general meetings.
   - Full and timely information regarding the issues to be decided at the meeting.

4. Shareholders can ask questions as well as submit the questions in advance and obtain replies from management and board members.

5. Shareholders have the basic right to share in the profit of the Corporation.

6. Shareholders have the basic right to elect the members of the board.

7. Shareholders have the right to participate and obtain relevant information about fundamental corporate changes i.e.
a. Amendments to the articles of incorporation or similar governing documents of the company.

b. The authorization of additional shares.

c. Extra ordinary transactions

8. There should be equal treatment for all shareholders including minority and foreign shareholders, such as –

   - Same voting rights.

   - Relevant information about the voting rights attached to all classes of shares.

   - Change in voting rights.

   - Processes and procedures of general shareholder meeting.

9. Custodians should cast the votes only when they are specifically authorized by the shareholders to do so. They should inform the shareholders about the options of their voting rights. They should disclose to the shareholders that, if no instruction is received, the custodians will vote the shares in the way they deem consistent with shareholder interest.

10. Insider trading and abuse self dealing should be prohibited.
11. Members of the board and managers should disclose any special interest which can affect the Corporation.

12. The rights of the stakeholders as established by law should be recognised. Thus, the stakeholders and corporations should actively co-operate to create wealth and job in such a way the corporations should remain sound.

13. Stakeholders should have the effective redress for violation of their rights.

14. There should be mechanisms which enhance the performance of stakeholders.

15. Stakeholders should have access to relevant information.

16. Companies should make maximum possible, timely disclosures on all matters related to their –
   - Financial situation including the balance sheet, the profit and loss statement, the cash flow statement, ownership data.
   - Policies relating to business ethics, the environment and public policies, human resource policy and policies related to governance structure.
- Members of the board and key executives, their experience, qualifications and material interest.

- Material risks such as risk from specific industry, specific location, dependence on major raw materials. There should be currency risk, financial market risk derivatives and off-balance sheet transactions.

- Management/employee relationship and stakeholders interrelationships.

17. The quality of information depends upon the standards of accounting, financial and non-financial disclosures and audit. Thus the information should be prepared, audited and disclosed with the held of above mentioned standards.

18. An Annual Audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

19. The content of the information as well as channels for the dissemination of information are important. Thus channels for
disseminating information should be provided for fair, timely and cost-efficient access to relevant information by users.

20. Board members should act in the interests of the company, shareholders and stakeholders.

21. The Board should treat all shareholders fairly.

22. The Board should select, compensate, monitor and when necessary, replace key executives.

23. The Board should review key executives and Board remuneration.

24. The Board should monitor and manage conflicts of interest of management, Board members and shareholders.

25. The Board should ensure the integrity of the corporation accounting and financial reporting systems.

26. The Board should review and guide corporate strategy, major plans of action, risk policy, annual budget, objectives and their implementation, corporate performance.

27. The Board should monitor the effectiveness of the governance practice.
28. The Board especially non-executive board members should be independent in judgment and decision making.

29. Board members should devote sufficient time to their responsibilities. They should have accurate, timely and relevant information.

2.5 The SEBI Code

The Committee on Corporate Governance was set up on May 7, 1999 by the Securities and Exchange Board of India (SEBI) under the Chairmanship of Shri Kumar Mangalam Birla to promote and raise the standards of corporate governance. The Committee kept in view the fact that any code of corporate Governance should be dynamic, and should change with changing context and times. This code is the first formal and comprehensive attempt, in the context of prevailing conditions of governance in Indian companies, as well as the state of capital markets.

The Committee divided its recommendations into mandatory and non-mandatory categories. The mandatory recommendations are the following:

1. The mandatory recommendations, such as composition of the Board, constitution of the various sub-committees of the Board of
Directors, should be implemented by companies within the time prescribed below:

*Immediately, by all companies seeking listing for the first time.*

*By April 2000,* by those companies, which satisfy any of the following criteria:

- Paid up share capital is Rs. 100 million and above; or
- networth, has reached Rs. 250 millions, any time in the history of the company.

*By April 2001,* by those companies, which qualify for following criteria:

- Paid up share capital of Rs. 50 million and above.

2. The board of a company has an optimum combination of executive and non-executive directors with fifty percent of the board comprising the non-executive directors. The number of independent directors would depend on the nature of the chairman of the board. In case of a non-executive chairman, at least one-third of board should comprise of independent directors and in case of an executive chairman, at least half of board should be independent.
3. A non-executive Chairman should be entitled to maintain a chairman’s office at the company’s expense and also allowed reimbursement of expenses incurred in performance of his duties. This will enable him to discharge the responsibilities effectively.

4. A qualified and independent audit committee should be set up by the board of a company. This would go a long way in enhancing the credibility of the financial disclosures of a company and promoting transparency.

- The audit committee should have minimum three non-executive directors, majority being independent with at least one director having financial and accounting knowledge;
- The chairman of the committee should be an independent director;
- The chairman should be present at Annual General Meeting to answer shareholder queries;
- The finance director, head of internal audit and a representative of external auditor should be present as invitees for the meeting of the audit committee;
The Company Secretary should act as the secretary of the committee.

To begin with the audit committee should meet at least thrice a year. One meeting must be held before finalisation of annual accounts and one necessarily every six months.

The quorum should be either two members or one-third of the members of the audit committee, whichever is higher.

Being a committee of the board, the audit committee derives its powers from the authorisation of the board. Such powers should include:

- To investigate any activity within its terms of reference.
- To seek information from any employee.
- To obtain outside legal or other professional advice.
- To secure attendance of outsiders with relevant expertise, if it considers necessary.

Functions of the Audit Committee

As the audit committee acts as the bridge between the board, the statutory auditors and internal auditors, its role should include the following:
• Oversight of the company’s financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

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

• Reviewing with management the annual financial statements before submission to the board, focussing primarily on:
  • Any changes in accounting policies and practices.
  • Major accounting entries based on exercise of judgement by management.
  • Qualifications in draft audit report.
  • Significant adjustments arising out of audit.
  • The going concern assumption,
  • Compliance with accounting standards.
  • Compliance with stock exchange and legal requirements concerning financial statements.
• Any related party transactions i.e. transactions of the company of material nature, with promoters or the management, their subsidiaries of relatives etc. that may have potential conflict with the interests of company at large.

• Reviewing with the management, external and internal auditors, the adequacy of internal control systems.

• Reviewing the adequacy of internal audit function, 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.

• To discuss with internal auditors any significant findings and follow-up thereon.

• 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.
• To discuss with external auditors before the audit commences, the nature and scope of audit. Also have post-audit discussion to ascertain any area of concern.

• Reviewing the company’s financial and risk management policies.

• To look into the reasons for substantial defaults in the payments to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors.

5. The board should 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.

To avoid conflicts of interest, the remuneration committee, which would determine the remuneration packages of the executive directors, should comprise minimum of three non-executive directors, the chairman of committee being an independent director.
All the members of the remuneration committee should be present at the meeting. The Chairman of remuneration committee should be present at Annual General Meeting, to answer the shareholder queries. The remuneration of non-executive directors should be decided by the entire board of directors. The recommendations of the board of directors would need to be ratified at the General Body meeting of shareholders and in case the board disagrees with the recommendations of the remuneration committee, the matter should be decided at the General body meeting of the shareholders who should be provided with sufficient information about the remuneration policy and package.

6. It is important for the shareholders to be informed of the remuneration of the directors of the company. Therefore, the following disclosures should be made in the section on corporate governance of the annual report:

- All elements of remuneration package of all the directors i.e. salary, benefits, bonuses, stock options, pension etc.
- Details of fixed component and performance linked incentives, along with the performance criteria.
- Service contracts, notice period, severance fees.
Stock option details, if any and whether issued at a discount as well as the period over which accrued and over which exercisable.

7. Board meetings should be held at least four times in a year, with a maximum time gap of four months between any two meetings. To ensure that the members of the board give due importance and commitment to the meeting of the board and its committees, there should be a ceiling on the maximum number of committees across all companies in which a director could be a member or act as chairman. A director should not be a member in more than 10 committees or act as chairman of more than five committees across all companies in which he is a director.

8. The companies should be required to give consolidated accounts in respect of all its subsidiaries in which they hold 51% or more of the share capital.

9. The board should clearly define the role of the management. The management should carry out the following functions:
• Assisting the board in its decision making process in respect of the company’s strategy, policies, code of conduct and performance targets, by providing necessary inputs.

• Implementing the policies and code of conduct of the board.

• Managing the day to day affairs of the company to best achieve the targets and goals set by the board to maximize the shareholder value.

• Providing timely, accurate, substantive and material information, including financial matters and exceptions, to the Board of Directors, board-committees and the shareholders.

• Ensuring compliance of all regulations and laws.

• Ensuring timely and efficient service to the shareholders and to protect shareholders’ rights and interests.

• Setting up and implementing an effective internal control system, commensurate with the business requirements.

• Implementing and comply with the Code of Ethics as laid down by the board.
• Co-operating and facilitating efficient working of board committees.

As part of the disclosure related to Management, the Committee recommended that in addition to the director’s report, Management Discussion and Analysis report should form part of the annual report to the shareholders. This Management Discussion & Analysis should include the following within the limits set by the company’s competitive position:

• Industry structure and developments.
• Opportunities and Threats.
• Segment-wise or product-wise performance.
• Outlook.
• Risks and concerns.
• Internal control systems and their adequacy.
• Discussion on financial performance with respect to operational performance.
• Material developments in Human Resource/Industrial Relations front, including number of people employed.
10. Disclosures must be made by the management 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 example, dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.).

11. In case of the appointment of a new director or re-appointment of a director a shareholder must be provided with the following information:

- A brief resume of the director;
- Expertise in specific functional areas; and
- Names of companies in which the person also holds the directorship and the membership of Committees of the board.

12. The half-yearly declaration of financial performance including summary of the significant events in last six-months, should be sent to each household of shareholders.

A board committee under the chairmanship of a non-executive director should be formed to specifically look into the redressing
of shareholder complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc.

To expedite the process of share transfers the board of the company should delegate the power of share transfer to the registrars and share transfer agents.

13. There should be a separate section on Corporate Governance in the annual reports of companies, with a detailed compliance report on Code of Corporate Governance. Non-compliance of any section of the code and the reasons thereof should be specifically highlighted. This will enable the shareholders and the securities market to assess for themselves the standards of corporate governance followed by a company.

The report of the Committee was considered and adopted by SEBI Board in its meeting held on January 25, 2000. The recommendations are to be implemented through the amendment to listing agreement of the stock exchanges. Internationally listing agreement has been used in most markets to implement corporate governance in the listed companies. Accordingly, on February 21, 2000, SEBI has issued
directions to stock exchanges to amend the listing agreement in this regard.

The amendments to the listing agreement are to be implemented as per schedule of implementation given below:

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

- Within 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 S&P CNX Nifty index as on January 1, 2000. However, to comply with the recommendations, these companies may have to begin the process of implementation as early as possible.

- Within 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.100 million and above, or net worth of Rs.250 million or more any time in the history of company.
• Within financial year 2002-2003, but not later than March 31, 2003 by all the entities which are presently listed, with paid up share capital of Rs.30 million and above.

The first phase to be completed by March 31, 2001 was to cover more than 80% of the market capitalization.

In February 2000 the Securities and Exchange Board of India issued a letter to all the stock exchanges proposing that 'a new clause, namely clause 49, be incorporated in the listing agreement'. Clause 49, called 'Corporate Governance', contains eight sections dealing with the Board of Directors, Audit Committee, Remuneration of Directors, Board Procedure, Management, Shareholders, Report on Corporate Governance, and Compliance, respectively. The salient features are the following:
• In future at least one-third of the board should consist of independent directors, 'independence' being defined as any material, pecuniary relationship or transactions with the company, other than the director's remuneration, which in the judgment of the board may affect a director's independence of judgement
• Companies shall have a ‘qualified and independent’ audit committee with a majority of independent directors

• The Annual Report shall disclose details of the remuneration of directors

• The Annual Report should contain a Management Discussion and Analysis ‘as part of the director’s report or as an addition there to’

• Annual Report shall contain a separate section on Corporate Governance detailing compliance with the mandatory and non-mandatory requirements proposed by SEBI.

In addition, the Companies (Amendment) Act, was passed in 2000. The act, among other things, introduces arms-length auditors, provides for improved protection of small investors, improves the transparency of Initial Public Offerings (IPOs) and requires a clear statement on Director’s responsibilities in the reports of Boards of companies. The salient features of the Companies (Amendment) Act, 2000 are the following:

• All provisions concerning issue and transfer of securities and non-payment of dividends in case of listed public companies and those planning to list shall be administered by SEBI.
• The share capital of shareholder limited company shall be of two kinds only: (i) equity share capital, with voting rights and (ii) preference share capital.

• Dematerialised form will be compulsory for listed companies making Initial Public Offering (IPO) of any security for a sum of Rs.100 million or more.

• Specific provisions for appointment of Debenture Trustees and creation of debenture redemption reserve have been made.

• Voting through postal ballot for important items has been prescribed

• The Report of Board of Directors should include a statement on Directors’ responsibilities

• A holder of security with voting rights in a company is not eligible for appointment as its auditor

• A public company having a paid-up capital of Rs.50 million or more and one thousand or more small shareholders may appoint at least one director elected by small shareholders on its Board
• Confirmation by the Regional Director is compulsory for changing a Company's Registered Office from the jurisdiction of one Registrar of Companies to that of another

• Provisions have been made to ensure the protection of small investors; a small depositor is defined as one who has deposited in a financial year a sum not exceeding Rs.20,000/- in a company, and includes successors, nominees and legal representatives.

Until February 1997, companies could structure quietly negotiated takeover deals, which left minority shareholders in the lurch. This changed with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 1997, which is popularly known as the Takeover Code. The SEBI regulation has had two beneficial effects. First, it has created a transparent market for takeovers. Second, by legislating in favour of open offers, it has ensured that minority shareholders will have the right to obtain a market driven price in any takeover.

The quality of financial disclosure in the annual accounts of incorporated companies in India is determined by three agencies: (i) The Department of Company Affairs, which administers the Companies Act, (ii) SEBI, which mandates special disclosure requirements for listed
companies, and (iii) the Institute of Chartered Accountants of India (ICAI) which lays-down the parameters of Indian accounting standards. While these standards are better than what prevails in most of Asia, including Korea and Japan, they are behind the norms laid down by US-GAAP. The most serious lacunae are the absence of consolidation, lack of segment reporting, and low standards of disclosure of related party transactions.

*In the US-GAAP consolidation of accounts is compulsory, with line-by-line aggregation for subsidiaries and equity pro-rated adding-up for associate companies. But in India consolidation is not statutory. In the US-GAAP, wherever possible all assets and liabilities, including physical assets, are recorded at market value. But in India assets and liabilities are recorded at historical value, except for quoted securities. But in the US-GAAP depreciation is charged according to fair value or salvage value as calculated by management. But in India depreciation is charged according to rates specified in the Companies Act. More seriously, there are two sets of depreciation rates - one for computing profits in the profit and loss account (as per the Companies Act), and another for income tax purposes (as per the Income Tax Act,*
Anomalies between the two are embedded in the provision for income tax. These differences frequently induce management to adopt the lowest possible rates for the profit and loss account (thus showing large profits before tax), and the highest ones for income tax calculations. In the US-GAAP Segment reporting is compulsory. But in India there is no real segment reporting. In the US-GAAP accounting for deferred tax liability is compulsory. But in India it is not accounted for at all. In the US-GAAP related party disclosure is very elaborate. But in India Companies Act requires a small element of related party disclosures – which must be kept separately in a register. However, this is nowhere near as elaborate and informative as US-GAAP.

Nevertheless, there are a number of areas, which need strengthening. There is misleading reporting of intra-group transactions, which may be rectified by making consolidation of corporate groups’ financial statements mandatory. This can be done by changes in the Accounting Standard on consolidated financial statements. The Institute of Chartered Accountants of India should be able to affect this change.
There is only limited oversight of most listed Indian companies. This is because their boards are dominated by management (executive directors) or 'gray outsiders' (defined to include family members of executive directors, attorneys who represent the company, investment or commercial bankers who have close financial relationship with the company, long term consultants, or directors who have substantial business dealings with the company). At the same time, the Companies Act allows one person to hold up to 20 directorships, which is too many, if effective oversight is desired. Even if this is amended, given the fact that insiders are likely to have more information than outsiders, the directors representing minority shareholders are often helpless to protect the latter. There is also the problem in India of the inadequacies of SEBI, as a regulator. SEBI's list of uncompleted investigations continues to rise, while the maximum penalty of Rs.500,000/- is too low to deter market manipulations by insiders. The former reflect the inadequacies of staff at SEBI, the latter the inadequacies of law. The former needs to be strengthened through the addition of more competent and motivated staff, while the latter requires amendments to the law to raise penalties, which would act as deterrence to such market manipulators.
Unlike the German lead banks, which have played an effective monitoring role, as major debt and equity holders, the Indian banks and financial institutions have failed to play such a role for a number of reasons. Probably the principal reason is that the major banks and mutual funds are under the control of the government. They are buffeted by contradictory pulls by the various ministries and therefore have difficulty in focusing on commercial accountability. The government involvement also raises the moral hazard problem with the financial institutions exposing themselves to risky lending and activities, because they know that they will be bailed out by the government, if they run into difficulties, for instance, UTI's Cyberspace investment and the excessive exposure of its US-64 to the info tech stocks. It is also likely that the banks lack qualified staff to monitor the activities of the corporations to which they are major lenders. They rely for information, in any case on the management, and seem to be captive of it, because they tend to support its decisions. Unless, there are incentives in terms of bonus payments for effective monitoring by the financial institutions' representatives on the boards of companies, as well as penalties for poor monitoring, this state of affairs will not change.
The most serious concern is with India’s bankruptcy and liquidation laws and procedures. These are inadequate, time consuming and contribute to poor governance by management. Bankruptcy reorganization of large industrial organizations is governed by the Sick Industrial Companies (Special Provisions) Act, 1985 and the process is supervised by the Board for Industrial and Financial Reconstruction (BIFR). The latter tends to support the rights of existing management and of old shareholders over fully secured creditors. Liquidation poses even more serious problems. This is because most liquidation cases take between one to two decades to complete, resulting in a system that works against the interests of workers and secured creditors. Since management fears neither attachment nor bankruptcy, it leads to companies funding highly risky investments, which has several adverse consequences. It raises the cost of credit, it debases the disciplining role of debt and it increasingly risks the health of the financial sector. Under planned legislation BIFR will be replaced by National Company Law Tribunal, which will oversee revival, amalgamation and winding up of sick companies. The new legislation will also end the open-ended nature of BIFR proceedings by requiring winding up operations to be
completed within 24 months. The legislation also requires the criterion for defining sickness to be made tighter, thus making it more likely for the failing company to be revived. The proposed legislation has run into opposition, because it requires the payment of a levy of 0.005% rising to 1% on companies' turnover (The Hindu, “End of the BIFR era”, 22nd of August 2001). But given that it will provide a revolving fund for failing companies and it is in the interest of the corporate sector to have a healthy corporate sector, it should not be seen as an attempt to fleece the healthy to support the poorly managed.

It is apparent from the above that though new laws, especially if they facilitate speedier resolutions and protect workers and secured creditors, will help, the major problems relate to delays in enforcing existing laws and securing outcomes, as in the case of SEBI and BIFR within a reasonable time frame. In addition, with 28 million cases pending and mounting arrears, it can take up to 20 years before a decision is obtained and enforced. With large number of state and central statutes, often with conflicting definitions and language, which require legal interpretation and delays because of procedural and
multiple appeals against the lower courts; India’s business and legal environment is seen to be one of the most difficult.

2.6 Sarbanes Oxley Act of 2002

To develop an act on Corporate Governance, one hundred seventh congress of the U.S.A. at the second session begun and held at the city of Washington on 23 January, 2002. The act was framed to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities lows and for other purposes. This ‘Sarbanes Oxley Act of 2002’ has eleven titles. The titles are:-

I. PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

1.01 This board is established –

- to oversee the audit of public companies
- to protect the interests of investors and further the public interest.

• The board shall operate as a non-profit corporation until dissolved by an act of congress.

• The board shall have five members appointed from among prominent individuals of integrity and reputation.
• The board shall have only two members who have been certified public accountants.
• The member as well as the chairperson of the Board may not serve for more than two terms.

1.02 Each public accounting firm shall apply and submit all the required details for registration with the Board. The Board shall approve a complete application for registration not later than 45 days after the date of receipt of the application or issue a written notice of disapproval. To update the details of application, each firm shall submit its annual report to the Board. The Board shall assess and collect a registration fee and annual fee from each registered public accounting firm to recover the costs of processing and reviewing applications and annual reports.

1.03 The board shall establish auditing standards, quality control standards and ethics standards to be used by registered public accounting firms, in the public interest or for the protection of investors.

1.04 The Board shall inspect, each registered public accounting firm and associated persons of that firm,
annually if the firm regularly provides audit reports for more than 100 issuers.
- Not less frequently than once every three years if the firm regularly provides audit reports for 100 or fewer issuers.

1.05 The Board shall establish fair procedures for the investigation and disciplining of registered public accounting firms and associated persons of such firms. If a registered firm or any associated person refuses to testify, produce documents or cooperate with the board, the Board may:
- suspend or bar such person from being associated with a registered public accounting firm or required the registered public accounting firm to end such association.
- Suspend the registration of the public accounting firm.

1.06 Any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer, shall be subject to this Act and the rules of the Board and the Commission issued under this Act, in the same manner as to the same extent as a public accounting firm that is organized and operates under the laws of the United States or any State.
1.07 The Commission shall have oversight and enforcement authority over the Board, as provided in this Act. No rule of the Board shall become effective without prior approval of the commission.

II. AUDITOR INDEPENDENCE

2.01 The Board may provide non-audit services, including:

- bookkeeping or other services related to the accounting records or financial statements of the audit client.
- financial information systems design and implementation;
- valuation services, fairness opinions;
- actuarial services;
- management functions or human resources;
- broker or dealer, investment adviser
- any other service that the Board determines is impermissible.

2.02 All the auditing services and non-audit services, provided to an issuer by the auditor of the issuer shall be pre-approved by the audit committee of the issuer.

2.03 It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead audit partner, or the
audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.

2.04 Each registered public accounting firm that performs for any issuer any audit required by this title shall timely report to the audit committee of the issuer—

- all critical accounting policies and practices to be used.
- all alternative treatments of financial information.
- other material written communications between the registered public accounting firm and the management of the issuer.

2.05 There are some amendments at the end of the title.

2.06 It shall be unlawful for a registered public accounting firm to perform for an issuer any audit service required by this title, if a chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for the issuer, was employed by that registered independent public accounting firm and participated in any capacity in the audit of
that issuer during the 1-year period preceding the date of the initiation of the audit.

2.07 The Comptroller General of the United Stated shall conduct a study and review of the potential effects of requiring the mandatory rotation of registered public accounting firms.

2.08 Not later than 180 days after the date of enactment of this Act, the Commission shall issue all final regulations.

2.09 In supervising non-registered public accounting firms and their associated persons, appropriate state regulatory authorities should make an independent determination of the proper standards applicable.

III CORPORATE RESPONSIBILITY

3.01 There are some amendments in Commission rules, Responsibility and Independence of public accounting firms.

3.02 The Commission shall certify in each annual or quarterly report that –

- the signing officer had reviewed the report.
- The report doesn’t contain any untrue statement.
The financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer.

The signing officers are responsible for establishing and maintaining internal controls.

3.03 It shall be unlawful for any officer or director of an issuer, or any other person acting under the direction thereof, to take any action to fraudulently influence, coerce, manipulate or mislead any independent public or certified account.

3.04 If an issuer is required to prepare an accounting restatement due to the material non-compliance of the issuer, the chief executive officer and the chief financial officer of the issuer shall reimburse.

3.05 It shall be unlawful for any director or executive officer of an issuer of any equity security, directly or indirectly, to purchase, sell or otherwise acquire or transfer any equity security of the issuer during any blackout period.
3.06 The Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys.

3.07 The Commission may collect civil penalty from the person who violates law and give it to the victims of such violation.

IV ENHANCED FINANCIAL DISCLOSURES

4.01 Each financial report shall reflect all material correcting adjustments that have been identified by a registered public accounting firm in accordance with generally accepted accounting principles and the rules and regulations of the Commission.

4.02 It shall be unlawful for any issuer directly or indirectly, including through any subsidiary, to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer of that issuer.

4.03 Directors, Officers and Principal stockholders shall file the statements. The statements shall be filled –

- at the time of the registration of securities.
- Within 10 days after he or she becomes such beneficial owner, director or officer.
- If there has been a change in ownership.

4.04 The Commission shall prescribe rules to contain an internal control report, which shall –

- state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting
- contain an assessment of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

4.05 The amendments made by above sections or the rules of the Commission under those sections shall apply to any investment company registered under section 8 of the Investment Company Act of 1940.

4.06 The Commission shall issue Code of Ethics for Senior Financial Officers. The Commission shall revise it according to the requirement.
4.07 The Commission shall issue rules, to disclose whether or not, and if not, the reasons therefore, the audit committee of that issuer is comprised of at least 1 member who is a financial expert.

4.08 The Commission shall review disclosures made by issuers. Such review shall include a review of an issuer's financial statement.

4.09 Each issuer shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer, in plain English, which may include trend and qualitative information and graphic presentations, as the Commission determines, by rule, is necessary or useful for the protection of investor and in the public interest.

V ANALYST CONFLICTS OF INTEREST

5.01 The Commission, a registered securities association or national securities exchange, shall have adopted rules reasonably designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances, to improve the objectivity of research and provide investors more useful and reliable information.
VI COMMISSION RESOURCES AND AUTHORITY

6.01 In addition to any other funds authorized to be appropriated to the Commission, there are authorized to be appropriated to carry out the functions, powers and duties of the Commission, $776,000,000 for fiscal year 2003, of which –

- $102,700,000 shall be available to fund additional compensation, including salaries and benefits.

- $108,400,000 shall be available for information technology, security enhancements, and recovery and mitigation activities in light of the terrorist attacks of September 11, 2001.

- $98,000,000 shall be available to add not fewer than an additional 200 qualified professionals to provide enhanced oversight of auditors and audit services required by the Federal securities laws.

6.02 The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is
found by the Commission, after notice and opportunity for hearing in the matter –
- not to possess the requisite qualification
- to be lacking in character or integrity
- to have willfully violated.

6.03 The Court has authority to prohibit persons from participating in an offering of penny stock i.e. any person engage in activities with a broker, dealer for purpose of trading, inducing or attempt to induce the purchase or sale.

6.04 The associated persons of brokers and dealers shall be fully qualified.

VII STUDIES AND REPORTS

7.01 The Comptroller General of the United States shall conduct a study to identify –
- the factors that have led to the consolidation of public accounting firms since 1989 and the consequent reduction in the number of firms.
- the present and future impact of the above condition on capital formation and securities markets.
problems faced by firms including costs, quality of services, lack of choice.

whether and to what extent Federal or State regulation impede competition among public accounting firms.

- The comptroller General shall consult with the Commission, the regulatory agencies, the department of justice and any other public or private organization that the Comptroller General Considers appropriate.

- The Comptroller General shall submit a report on the results of the study.

7.02 The Commission shall conduct a study of the role and function of credit rating agencies and submit a record on the study to the President, the Committee on financial services of the House of Representatives and the Committee on Banking, Housing and Urban Affairs.

7.03 The Commission shall conduct a study to determine, based upon information for the period from January 1, 1998 to December 31, 2001, the number of securities professionals who violate the Federal security law and make a report based on this study.
7.04 The Commission shall review and analyze all enforcement actions by the Commission involving violations of reporting requirements imposed under the securities laws and restatements of financial statements and report it to the Committee on financial services. The report shall include a discussion of regulatory or legislative steps.

7.05 The Comptroller General of the United States shall conduct a study on whether investment banks and financial advisers assisted public companies in manipulating their earnings and obfuscating their true financial condition and report to congress. The report shall include a discussion of regulatory or legislative steps.

VIII CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY

8.01 The person who knowingly alters, destroys, covers up, falsify or make any false entry in any record shall be fined under this title, imprisoned not more than 20 years, or both. The person who violates the rules of Securities and Exchange Commission shall be fined under this title, imprisoned not more than 10 years, or both.
8.02 The debtor has to owe all the payments including damages, fine, penalty, attorney fee, and cost if he incurred in violation of securities fraud laws.

8.03 The United States sentencing Commission shall review and amend the Federal sentencing guidelines and related policy statements to ensure that –
- the base offense level and existing enhancements are sufficient to deter and punish that activity.
- the guidelines offence levels are sufficient to deter and punish that activity.

8.04 There shall be protection for employees of publicly traded companies who provide evidence of fraud.

8.05 The person shall be fined or imprisoned not more than 25 years, or both for defrauding shareholders of publicly traded companies.

IX WHITE COLLAR CRIME PENALTY ENHANCEMENTS

9.01 Any person who attempts or conspires to commit or commit any offense shall be subject to the penalties.

9.02 There shall be criminal penalties for mail or wire fraud.
9.03 Criminal penalties for violations of the employee retirement Income Security Act of 1974 are amended.

9.04 The United States sentencing Commission shall review and amend the Federal sentencing guidelines and related policy statements to implement the provisions of this Act.

9.05 Each periodic report containing financial statements shall be accompanied by a written statement by the Chief Executive Officer and Chief Financial Officer of the issuer. The statement shall certify that the periodic report containing the financial statements fully complies with the requirements and the information is true.

X CORPORATE TAX RETURNS

10.01 It is the sense of the Senate and the Federal income tax return of a corporation should be signed by the Chief Executive Officer of such corporation.

XI CORPORATE FRAUD ACCOUNTABILITY

11.01 A person who alters, destroys, conceals a record or document or obstructs, influences any official proceeding shall be fined under this title or imprisoned not more than 20 years, or both.
11.02 During the course of a lawful investigation, the Commission may petition a Federal district court for a temporary freeze of required documents.

11.03 The United States Sentencing Commission shall review the guidelines, add new guidelines and submit them to congress.

11.04 The Commission may issue an order to prohibit, conditionally or unconditionally, any person who has violated the rules from acting as an officer or director of an issuer.

11.05 Criminal Penalties are increased under Securities Exchange Act of 1934 from $1,000,000 or imprisoned not more than 10 years to $5,000,000 or imprisoned not more than 20 years.

11.06 The person, who knowingly takes any harmful action to true informer, shall be fined under this title or imprisoned not more than 10 years, or both.”

2.7 Conclusion

Good corporate governance is the key to efficiency in a competitive environment. In this corporate governance provides a cutting edge. Good corporate governance is not merely desirable but it is essential for survival. It is necessary not just because it is good for the
shareholders and other stakeholders, it is essential because it is in the interest of the company itself in the present competitive environment. It is good for the shareholders because it is good for the company on which their future depends. Good corporate governance should, of course, emphasise ethicality. Decision making processes should be transparent, consistent with the need to protect the competitive interests of the company as otherwise shareholders and other stakeholders in the enterprise would lose out.

Internationally, corporate governance norms have been initiated through a judicious mix of the three available routes: legislation, regulation, or self-discipline and free volition. Often, a fourth driver is also evident in the form of societal pressures. In counties with well-developed economies, capital markets, and commercial and citizen awareness, legislative interventions are minimal and not the preferred option. Regulatory agencies such as capital market regulators, professional bodies and central banks play an important role in bringing about an orderly and disciplined regimen among their constituents. Self-regulation through persuasion comes about through initiatives taken by industry chambers and business associations, often also aided by
globalisation initiatives that dictate adoption of international best practices. Societal pressures impact on corporate social responsiveness and often manifest in corporate responses well beyond legislative demands concerning ecology, environment, community development, and so on. In today’s context what is required is a new model of corporate governance which recognizes and respects the trusteeship concept acknowledging corporate personality, allowing the executive entrepreneurial scope to achieve organizational objectives and yet holding it accountable and responsible for its performance.