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Levers of Corporate Governance in India: Critical Analysis through Prism of Legal Framework

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Prologue:

Corporate Governance is the relationship between corporate managers, directors and the capital providers, who save and invest their capital to earn money in form of dividend, interest or gain. Shareholders of the company appoint Board of Directors[1] to fulfill their objectives aligned with the corporate objectives. Board of Directors appoints key managers for implementing corporate strategies. Corporate objectives are attained with the series of actions of the directors & managers. Capital & other necessary resources are provided by shareholders and other stakeholders to the company to fulfill the common objectives. It entails responsibility of corporate managers towards investors, society & environment that provides valuable resources to the corporation in achieving their objectives. Good corporate governance practices ensure that the board of directors is accountable for the pursuit of corporate objectives to enhance wealth of corporation[2] and that the corporation itself conforms to the law and regulations in form & spirit. This paper identifies who are the levers of corporate governance and then investigates the powers of those levers, which influences the quality of corporate governance in corporate India. We critically analyze the effectiveness of Indian legal framework to ensure good corporate governance practices. The actors who can influence the quality of corporate governance are depicted in Chart-1 classified into (i) Internal: including shareholders, independent directors, audit & nomination committee and (ii) External: including auditors, Registrar of Companies, stock exchanges, Security Exchange Board of India and the Competition Commission of India.

The Emerging Corporate Scenario in India

The Corporate form is increasingly emerging as the preferred vehicle for economic and commercial activity, with mobilization of public resources. The number of companies has expanded from about 30,000 in 1956 to nearly a million as on date[3]. Listed companies in 2011-12 at National Stock Exchange & Bombay Stock Exchange were 1646 & 5133 respectively[4].

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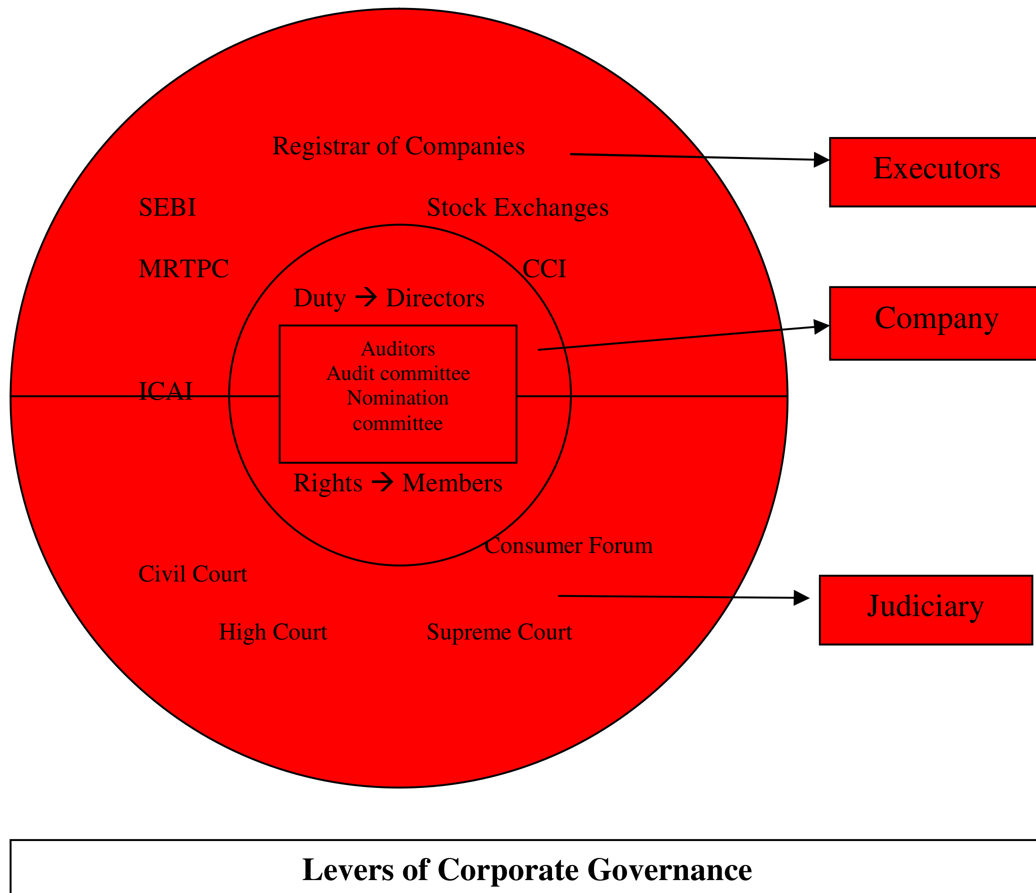
[1] Companies Act, 1956
[2] Sapovadia, Corporate Governance as Tools to Wealth Maximization
[3] Ministry of Corporate Affairs, Government of India
[4] Source: SEBI Annual Report 2011-12 & NSE, BSE Report

This cast responsibility on the government and to help sustain this growth by enabling a legal framework that enable the Indian corporate sector to operate in an environment of the best international practices in a globally competitive manner, while fostering a positive environment for investment and growth.

Chart-1



Levers of Corporate Governance

Good corporate governance ensures that the business environment is fair and transparent and that companies can be held accountable for their actions. Good corporate governance also provides better access to capital and it aids national growth[5]. Corporate managers are expected to act ethically within the boundary of acceptable rules and provisions of law. Deviation in activity of a corporate than expected corporate governance practices may or may not have any financial implication, but adherence to the rules is extremely important. Corporate governance works on the basic axle of transparency, accountability, fairness and responsibility.

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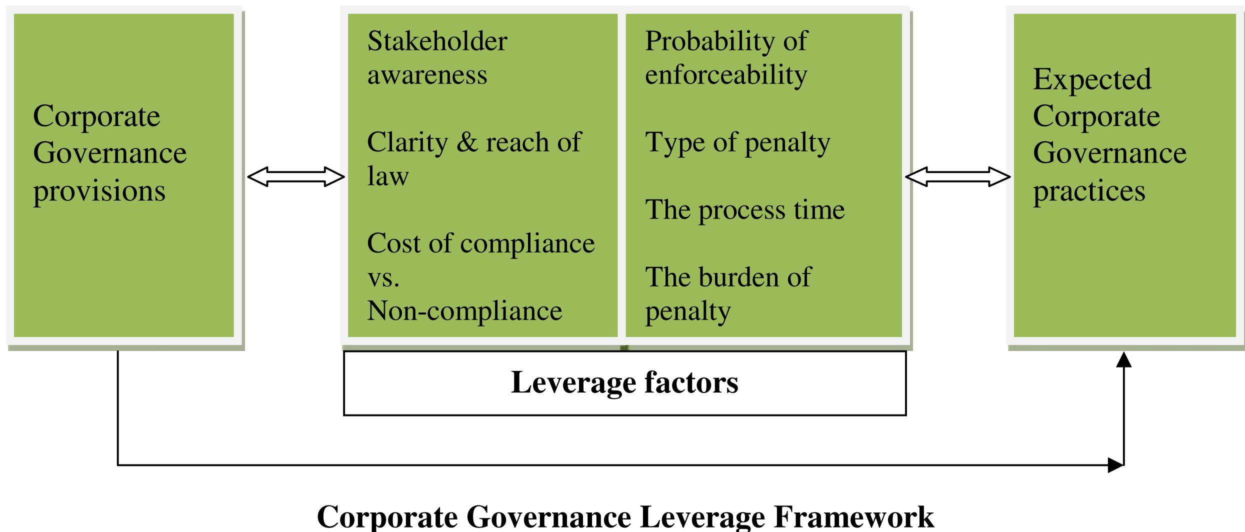
[5] IFC on Corporate Governance

Corporate governance tends to focus on the protection of shareholders and various stakeholders. Corporate governance framework struck balance between various conflicting interests amongst stakeholders. The legal framework cast obligations on the corporate managers to behave in prescribed manner and avail rights to the investors and regulators to ensure that the managers act accordingly. Investors, regulators and stakeholders can exercise their rights if corporate manager deviate from their duty. Broadly defined, "corporate governance" refers to the combination of laws, regulations, Accounting Standards & listing rules, and voluntary private sector practices that enable the corporation to attract capital, perform efficiently, generate profit and meet both legal obligations and general societal expectations. The quality of corporate governance depends upon effectiveness and efficiency of its regulatory framework; however it is not the sufficient condition for good corporate governance[6]. The legislations prescribing such a framework needs to be compact, amenable to clear interpretation, enabling the required regulatory institutional structures to develop and respond in a timely and appropriate manner to meet the requirements of ever evolving economic activities by keeping balance of justice amongst various stakeholders[7]. The actors of corporate governance should be proactive and compelling that the managers' tendency be attracted toward best compliance. In the case of non-compliance, the actors of corporate governance should be aggressive to enforce compliance with the help of conducive legal provisions and speedy process of enforceability. Corporate Governance Leverage factors are depicted in following **Chart-2.**



Corporate Governance Leverage Framework

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[6] Holly Gregory, Building the Legal and Regulatory Framework: Discussion

[7] Ira Millstein, The Evolution of Corporate Governance in United States

In order to ensure a smooth transition between different stages in a company's life cycle, the existence of a well-developed network and ecosystem is considered more essential than the introduction of more rules and regulations that address corporate governance issues[8]. The ecosystem is consist of those who are responsible for good corporate governance, the corporate managers and those who expect good corporate governance, the insiders[9] and outsiders[10]. The ecosystem is governed by the written rules and the spirit of corporate managers to adhere the rules with utmost spirit. Corporate performance is measured in terms of money, and hence along with the other rules, the rules related to preparing accounting and presenting financial statements of a company are of immense importance. Good corporate governance practices enhance adhering GAAPs[11] and Accounting Standards strictly.

Accounting Standards are policy documents relating to various aspects of measurement, treatment, presentation and disclosure of accounting transactions and events. The purpose of Accounting Standards is to standardize diverse accounting policies with a view to eliminate incomparability of financial statements. The objective is to provide a set of standard accounting policies which are in conformity with generally accepted principles and policies. Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI) were in force in the nature of advisories, but now every company registered under the Companies Act, 1956 is required to comply with Accounting Standards[12]. ICAI has notified 32 Accounting Standards.

India has adopted policy of Convergence with IFRS[13] keeping in view the requirements of change and transition necessary to be followed by Indian companies and regulatory bodies. Therefore, the initiative for harmonization of Indian Accounting Standards with the IFRS has been taken up with the intention of achieving convergence with IFRS by 2011, but till date, IFRS is not yet implemented. International Financial Reporting Standard (IFRS) is considered a "principles based" set of standards in that they establish broad rules as well as dictate specific treatments. There is also a Framework for the Preparation and Presentation of Financial

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[8] OECD Report, 2012
[9] Shareholders, Independent directors, Nomination Committee and Audit Committee etc.
[10] Registrar of Companies, SEBI, Stock Exchanges and other government agencies
[11] Generally Accepted Accounting Practices
[12] Pursuant to the provisions of section 211(3C) of the Companies Act, 1956, the Companies (Accounting Standards) Rules, 2006 were notified in the Gazette of India in December 2006.
[13] Ministry of Corporate Affairs, Press Note 1/1/2009-IFRS dated 4th May 2010

Statements which describes some of the principles underlying IFRSs. The objective of financial statements is to provide information about the financial position, performance and changes in the financial position of an entity that is useful to a wide range of users in making economic decisions, and to provide the current financial status of the entity to its shareholders and public in general.

To determine the quality of corporate governance, proactive role played by the shareholders and executives machinery is very important. The substantive law determines the effectiveness of adherence to good corporate governance, while procedural law determines the effectiveness of remedial actions in case of any deviation in governance practices. As Roscoe Pound memorably put it, between 'law in books' and 'law in action' makes difference the way in which rules are enforced will clearly affect agents' incentives to comply. The effectiveness of a regulatory regime, therefore, is a function of both substantive rules and enforcement mechanisms. As per report by Ministry of Company Affair's statement in 2006, over 400 companies listed on the stock exchanges in Mumbai are facing prosecution for violating various statutory requirements. The Department of Company Affairs (DCA) has moved for prosecution of these companies as they failed to file annual returns and submit balance sheets, mandatory under the Companies Act provisions.

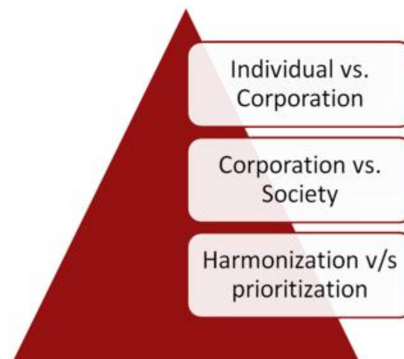
Principle of trusteeship:

After 1995, with global movement on corporate governance, India formulated committees on corporate governance (Kumar Manglam Birla, Narayan Murthy, Naresh Chandra & J.J. Irani Committee) at various level and basis of recommendation of such committees, SEBI (Security Exchange Board of India) codified clause 49 as part of security listing agreement. These codes are applicable to listed companies only, and there is no similar code for un-listed company how so big it is. Government of India announced guidelines in 2007 on corporate governance for Central Public Sector Units. However it is voluntary in nature. Various Accounting Standards[14] also incorporated financial issues on conflict of interest, related party transactions, transparency & disclosure. Clause 49 is exhaustive and provide for composition of board & audit committees

[14] Institute of Chartered Accountants of India

of independent directors, risk management, many specific disclosures in Annual Reports and certifying financial results.

As Institute of Company Secretaries of India states, "For making corporate governance work, we have to go through a profound metamorphosis and develop an inner value system which prides on ethics, morality, equity, legitimacy, transparency and values dissent and diversity." SEBI committee defined corporate governance: “Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company.” Indian cultural values are imbibed in corporate governance norms. We studied top Indian companies in terms of financial & market performance & probed companies facing governance problem and reasons thereof. The good corporate governance principle requires decisions in favour of interest of company rather than in interest of member or members. More particularly, in circumstances of conflict of interest, human tendency incline to decide in his favour instead of the company. Corporate Governance insists otherwise. In second situation, when, there is a conflict of interest between society (and state) and company, human tendency is to take decision that favours company, corporate governance principles expects otherwise.



Corporate Governance as harmonizing conflict of interest

There are different meanings in mind of investors, auditors & managers as to what corporate governance means and all seems to be valid. But large pool believes that corporate governance is law. Managers believe it as a tool of wealth maximization and hence an approach or a method.

Without much debating on the issue, we focus on the foundation of emergence of corporate governance, which is undoubtedly the interest of the investors and other stakeholders. As discussed hereinbefore we discuss the legal framework, purpose of it and its effectiveness in the light of empirical evidences.

Legal Framework to implement Corporate Governance:

To ensure good corporate governance, historically there is strong legal framework existing in India. But due to globalization, cutthroat competition, IT & media invasion, increasing social expectation, liberalization and political, economical, financial & legal reforms; existing legal framework is at stake and new corporate governance norms are evolving. Indian Constitutional Law of India is the root for direction in implementing good corporate governance. Article 38 directs government to ensure equitable distribution of wealth. The clause states that government should work to prevent concentration of wealth and means of production in a few hands, and try to ensure that ownership and control of the material resources is distributed to best serve the common good. SEBI appointed committee incorporated this view along with principle of trusteeship as envisaged by Mahatma Gandhi in defining corporate governance[15].

The structure of ownership of any business determines substantially, how a business is controlled and managed. The ownership structure in modern corporate generally is dispersed between numerous individual & group of individual or institute/s. If business is a company, the management & control vest in the hand of Board of Directors, duly elected by a democratic process as set up by the law. Due to various reasons, all shareholders are not participating in electing members of the board. The board members influence in setting & achieving objectives of the company and enjoy power of using companies' resources as they like within limits prescribed by Article & Memorandum of Association & Companies Act.

Company has to follow mandates of relevant Accounting Standards in preparing & reporting Financial Statements. Company Act provides provisions relating to special procedure when there

[15] "Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company." Report of the Committee on Corporate Governance of the Securities and Exchange Board of India, 2003

is conflicting interest of members of the Board or top management with the interest of the company. Accounting Standards issued by ICAI have control over its members if they fail to comply in his audit report. But ICAI has no authority to act against enterprise per se violating Accounting Standards norms. However, the accounting standards prepared and issued by the ICAI were mandatory only for its members, who, while discharging their audit function, were required to examine whether the said standards of accounting were complied with. With the amendment of the Companies Act, 1956 through the subsequent amendment[16], Accounting Standards are now indirectly integral parts of the Companies Act, which will provide statutory backing. It says that every company and its auditor shall comply with the Accounting Standards in the manner specified in the rules. As per Sec. 211, if while preparing financial statements, company have not followed the Accounting Standards, the company have to report the extent of any material deviation and reason thereof, in absence the company's financial statement shall not be 'true & fair'.

If the company is listed in any stock exchange, it has to further follow provisions of clause 49 of SEBI listing agreement. SEBI also ensure shareholder protection by various checks and preventing undue advantage of insider information and unfair takeovers. Financial Statements are the best indicators to report how corporate governance principles are executed. These statements are prepared on the basis of Generally Accepted Accounting Principles (GAAP). Accounting Standards prescribes recognition, valuation, reporting & disclosure of financial information. Globalization has opened new horizons for business to expand its operation but at the same time global transactions has new challenges to encounter. The parties to the business transaction many times take undue advantages from international business. Transaction amongst associate concerns & relatives require special scrutiny. Income Tax Act has enacted[17] provisions to assess true value of the transaction by incorporating principles of Transfer Pricing.

By and large express provision for corporate governance exists for listed companies only. There are no special provisions for family controlled companies. Central Government issued guidelines in 2007 on corporate governance for central public enterprises. It is voluntary in nature and there

[16] Companies Act, amendment in 1999, specifying rule in 2006
[17] Sections 92A to 92F of the Indian Income- tax Act, 1961

are no similar guidelines for state controlled public sector units as such. Similarly clause 49 applies to the listed companies and there are no express provisions on corporate governance issues for un-listed companies how so big it is. Companies Act, 1956 have implied provision that has bearing on corporate governance that applies to all class of companies.

The Government of India recognizing the importance of financial reporting in providing essential financial information about the company to its shareholders and other stakeholders, as an integral and important part of good corporate governance. Such information needs to be reliable, free from bias and should enable comparison on the basis of common benchmarks. This, in turn, necessitates an appropriate, financial reporting system in the form of accounting standards that incorporate sound accounting principles and reflect a true picture of the financial health of the company while ensuring legally enforceable accountability.

Execution of Legal Framework:

There are series of legislation measures, but there is no vigilant monitoring agency to bring on surface irregularities observed at any layer. There are various layers of executives, various agencies, but there is no coordination among them. In spite of several provisions, hardly few come to the notice of executives and even handful out of them are prosecuted. A note[18] by Bombay Stock Exchange (BSE) said, out of the 2,693 actively-traded companies where Clause 49 is applicable, approximately 18% have either not reported or have reported non-compliance for the quarter ended June 2006. Currently, 4,751 companies are listed on BSE. SEBI receives quarterly reports from Stock Exchanges regarding compliance with Clause 49 of the listing agreement. Clause 49 deals with corporate governance by companies listed on the exchanges. Based on these reports, SEBI[19] has initiated adjudication proceedings only against a total of 20 companies. Among adjudicated companies, five companies are public sector companies against whom proceedings have been launched for non-compliance with provisions relating to Board composition. Out of these 15 private sector companies, proceedings have been initiated against three companies for non-compliance with almost all the major provisions of Clause 49, against two companies for non-compliance with provisions like Board/Audit committee composition and

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[18] BSE
[19] SEBI

CEO/CFO certification, while for the balance 10 companies, proceedings have been initiated for non-submission of compliance reports on Clause 49 to the Stock Exchanges. The Securities and Exchange Board of India (SEBI) has initiated 'adjudication proceedings' against 20 companies for not complying with the Clause 49 provision of the listing agreement pertaining to corporate governance. Such action would involve imposing monetary penalties on the companies in question. This is the first time the market regulator has formally acted against companies for not adhering to the provision, which defines certain corporate governance rules for listed companies including board composition. Out of the 15 private sector companies, action has been initiated against three companies for non-compliance with almost all the major provisions of Clause 49. Two companies have not complied with provisions like board/audit committee composition and CEO/CFO certification, while the rest have not submitted compliance reports on Clause 49 to stock exchanges. The action against the state-owned companies has been initiated for non-compliance with provisions relating to board composition.

The Department of Company Affairs prosecuted[20] only 400 companies in 2006. Many of the companies are indulged into serious fraud and vanished with public money. As per department's note, the government suspects many of the companies against prosecution is launched might have vanished after raising money from the public. ''We have issued notices to them. But some of these letters have come back saying 'addressee not found',' ' said a government source. According to market estimates, assuming that each company mobilized an average of Rs 100 million, these companies might have raised at least Rs 4,0000 million from the capital market. Besides, at least Rs 1,0000 millions as investors' money could be locked up in these companies in the form of fixed deposits and other instruments. There is no reliable research on total stake of family based companies among all companies working in India. But it is believed that more than one third are family controlled business houses. Our study also substantiates these figures as outlined elsewhere in this report.

There are enough provisions in the Companies Act, 1956 & Indian Penal Code to penalize errant directors and officers, major problem lies in the fact that most of the provisions are in the statute book, rarely used and mostly misused or abused. Executing these provisions till adjudication ends is time consuming and hence its deterrent effect diminishes. Court procedures are highly

[20] Ministry of Corporate Affairs

cumbersome & slow. Few prosecution take place out of those reported for irregularities. There is no record how many violations go unrecorded. The solution therefore is to ensure proper corporate governance execution, monitoring, control and report deviation within stipulated time. There is strong need to make regulating institutions and laws functional. Another problem that make legal system ineffective, the courts are taking long time to dispose the case. Over a period of time and passing of the long time, the documents, witnesses, records are not available so evidences become weak, and offenders escape un-penalized.

According to the information made available[21], approximately 45,000 cases of prosecution filed by Registrars of Companies are pending in various trial Courts in the country. On account of the gap between the number of prosecutions filed and the cases disposed of, every year the pendency has been growing by nearly 2,000 cases. As per the available statistics, a very large number of pending cases for several years are such in which even initial service of summons has not been possible with the result that launching of prosecution in such cases has been infructuous.

Regulator for listed companies, SEBI undertakes compliance in matter of insider trading, manipulation of share prices and capital issues, non-compliance of listing agreement etc. As depicted in Annexure-4, during 2011-12, SEBI filed 1175 prosecutions under various Acts, while the court decided 240 resulting into 131 convictions. As per Annexure-5, during 1999-2000, SEBI filed 164 cases, while 90 were dismissed. There is no effective machinery to monitor implementation of corporate governance rules, whether they are observed or not on one hand while on other hand in large number of offenses, penalty is very small compared to gravity of offense and benefit grabbed by offender.

The current accounting and auditing system is not capable to fully protect interest of all stakeholders. The regulatory authority is also ill equipped either by powers, skills or will. The monitoring agencies are not functioning to the mark. The legislations and provisions are multiple and are vague in nature. There is no coordination between different agencies like SEBI, RBI, Department of Company Affairs etc. Penalties are small in many offenses, e.g. if a director, there

[21] Report of the Expert Group appointed by Government of India for streamlining prosecution mechanism under Companies Act, 1956

does not show conflict of interest is penalty is of Rs. 500 only, if auditors fail to qualify a report, then ICAI can take action against auditors. If provisions of Accounting Standards are not followed, auditor can merely make remark, which goes un-noticed for the shareholders. Shareholders are not literate, expert in financial matters or some time simply not interested. Shareholders elect directors by majority who are present in Annual Meeting. Only few shareholders are remaining present in the meeting and even very few raise questions during the meeting. Independent directors are not independent by spirit but influenced by the top executives. In the situation, corporate governance norms are not observed at various stages, and those are interested or responsible to implement fails to understand long-term impact of such violations.

Good Corporate Governance ensures better corporate performance, relationship with stakeholders, where the proper practice of Accounting Standards assumes immense importance at micro level, as effective disclosure leads to shareholders' wealth maximization and at macro level, they are essential to the efficient functioning of the economy because decisions about the allocation of resources/investment rely on credible, concise, transparent, comparable and understandable financial information about the corporate operations and financial position[22]. To practice Good Corporate Governance, information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non- financial disclosure. This paper, critically examine the relevant Accounting Standards and such practices in India, to evaluate potency and fairness vis-à-vis Good Corporate Governance.

Business enterprises are established for the profit, but as they uses resources supplied by the society/State and environment and hence are responsible to contribute part of the profit to society and environment also. Modern complex and big businesses are run by the persons (professionals) other than suppliers of the fund. This creates conflict of interest, among managers vs. corporation and corporation vs. society/environment. One prefers action for own benefit vs. company and benefit of company vs. society. It is good governance that harmonizes distribution of benefit judiciously amongst the different stakeholder without personal preference.

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[22] www.oecd.org/corporate/corporateaffairs

The importance of good Corporate Governance has increasingly recognized for improving the firm's competitiveness, better corporate performance and better relationship with all stakeholders**,** modern day corporations are known for the separation of ownership and control. After all, the managers are merely paid employees and the agency theory taught us that the independent managers can operate in a way that could be detrimental to the interests of the shareholder. It is, thus necessary, to have a mechanism by which the shareholders' interest are protected by the managers. It is here that Corporate Governance can play a crucial role. Professors Shleifer and Vishney, defined Corporate Governance as dealing with "the ways that suppliers of finance to corporations assure themselves of getting a return on their investment".

Corporate governance affects the interests of a larger cross-section of stakeholders and hence has implications for financial stability at macro level and is one of the key factors that determine the health of the system and its ability to survive economic shocks. Immediately after East Asia financial crisis, World Bank President, James Wolfensohn said that, World Bank will not extend any credit facilities to the country those who do not comply with international corporate governance norms, as corporate governance brings financial and economic stability.

The corporate responsibility begins with the directors who are the mind and soul of the organization. The Board is expected to act as conscience-keeper of the corporate vision and mission, and devise the right type of systems for organizational effectiveness and satisfaction of stakeholders. Thus, the Corporate Governance is a system of accountability primarily directed towards the shareholders in addition to maximizing the shareholders' wealth & welfare, where the debate on disclosure/ transparency issues of Corporate Governance eventually centers around the proper Accounting Standards, their practices and issues, as the application of Accounting Standards give a lot of confidence to the corporate management and the fair disclosure would be more effective and ensure the good Corporate Governance. Thus, the study of practices of Accounting Standards is an important and relevant issue of Good Corporate Governance in the present environment, as the standards are viewed as a technical response to call for better financial accounting and reporting; or as a reflection of a society's changing expectations of corporate behavior and a vehicle in social and political monitoring and control of the enterprise. More than the profits, it is the quality of governance, which will ensure corporate survival and growth and reinforce the faith of different stakeholders in the corporate entities. Unless company

develops a culture of accountability across the value chain, the organization will not be able to sustain the complexities of good governance. It is a question of the survival of the fittest. Those who exercise good governance practices have a greater change of success. It is looked upon as a distinctive brand and benchmark in the profile of corporate excellence.

McKinsey & Company's Global Investor Opinion Survey was conducted between April and May 2002, in collaboration with the Global Corporate Governance Forum. Its conclusions are based on responses from over 200 institutional investors representing about $2 trillion of assets under management. Findings include that corporate governance and financial disclosure are key factors in investment decisions and that reform priorities should focus on building financial system integrity. As per OECD principles of Corporate Governance, accounting information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosures**.** The application of high quality standards is expected to significantly improve the ability of investors to monitor the company by providing increased reliability and comparability of reporting, and improved insight into company performance. The quality of information substantially depends on the standards under which it is compiled and disclosed. The Principles support the development of high quality internationally recognized standards, which can serve to improve transparency and the comparability of financial statements and other financial reporting between countries. Such standards should be developed through open, independent, and public processes involving the private sector and other interested parties such as professional associations and independent experts. High quality domestic standards can be achieved by making them consistent with one of the internationally recognized accounting standards. In many countries, listed companies are required to use these standards.

OECD principles of Corporate Governance further emphasize that Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders. In some countries, the board is legally required to act in the interest of the company, taking into account the interests of shareholders, employees, and the public good. Acting in the best interest of the company should not permit management to become entrenched. This principle states the two key elements of the fiduciary duty of board members: the duty of care and the duty of loyalty. The duty of care requires board members to

act on a fully informed basis, in good faith, with due diligence and care. In some jurisdictions there is a standard of reference which is the behavior that a reasonably prudent person would exercise in similar circumstances. In nearly all jurisdictions, the duty of care does not extend to errors of business judgment so long as board members are not grossly negligent and a decision is made with due diligence etc. The principle calls for board members to act on a fully informed basis. Good practice takes this to mean that they should be satisfied that key corporate information and compliance systems are fundamentally sound and underpin the key monitoring role of the board advocated by the Principles. In many jurisdictions this meaning is already considered an element of the duty of care, while in others it is required by securities regulation, accounting standards etc. The duty of loyalty is of central importance, since it underpins effective implementation of other principles in this document relating to, for example, the equitable treatment of shareholders, monitoring of related party transactions and the establishment of remuneration policy for key executives and board members. It is also a key principle for board members who are working within the structure of a group of companies, even though a company might be controlled by another enterprise, the duty of loyalty for a board member relates to the company and all its shareholders and not to the controlling company of the group.

In recent years, the Indian economy has undergone a number of reforms, resulting in a more market-oriented economy**.** Particularly, after the Government of India embarked on liberalization and globalization of the economy, the size of Indian corporate are becoming much bigger and accordingly the expectations of various stakeholders are also increasing, which can be satisfied only by the Good Corporate Governance. And hence, Indian Corporate has obliged to reform their principles of Governance, Indian companies will now be required to make more and more elaborate disclosures than have been making hitherto, for which they are also required to adhere to the uniform and proper accounting standards, as the standards reduce discretion, discrepancy and improves the utility of the disclosure. Government of India has initiated process[23] to convergence of its accounting practices with that of international standards like IFRS. Accounting Standards are formulated to standardize the diverse accounting policies and practices with a view to eliminate to the extent possible the non-comparability of financial statements and

[23] Notification of Ministry of Corporate Affairs issued in 2010

add the reliability to the financial statements. Accounting Standards are well written documents, policy documents issued by expert accounting body or by Government or other regulatory body covering the aspects of recognition, measurement, treatment, presentation and disclosure of accounting transaction and events in the financial statement. It is also noteworthy that Government of India empowered Central Board of Direct Taxes to enact Accounting Standards for limited purpose of Accounting Method. The government has also processed separate Accounting Standards for Government accounting. But the ICAI plays an important role so far as Accounting Standards are concerned to the business firms. It is observed that small and medium enterprise have no adequate capabilities and resources to comply with all Accounting Standards, and hence not necessary to put them on same footing with big enterprises. ICAI has thus classified enterprises into three categories as under to differentiate the mandate and extent of disclosure of Accounting Standards vis-à-vis the public interest in the enterprise.

SEBI Complaints Redress System has been developed to address the grievances of any listed company. SCORES[24] is a web based centralized grievance redress system of SEBI. SCORES enables investors to lodge and follow up their complaints and track the status of redressal of such complaints online from the above website from anywhere. This enables the market intermediaries and listed companies to receive the complaints online from investors, redress such complaints and report redressal online. All the activities starting from lodging of a complaint till its closure by SEBI would be online in an automated environment and the complainant can view the status of his complaint online. An investor, who is not familiar with SCORES or does not have access to SCORES, can lodge complaints in physical form at any of the offices of SEBI. Such complaints would be scanned and also uploaded in SCORES for processing.

Conclusion:

The quality of corporate governance is sine-qua-non for sustainable relationship of amongst important stakeholders, growth the company and for growing economy. The legal framework does not suffice, unless there is an environment which provides assurance that the company will act as what is written in the law books, and any deviation will result into actions to bring justice. This assurance is possible, if the shareholders, creditors and other investors are aware about their

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[24] http://scores.gov.in

rights. The governing law should be clear in terms of defining duties, obligations, accountability and consequences. The process to execute provisions of law should be efficient and effective, at a nominal cost and in timely manner. The erring people must get punishment commensurate with gravity of offense and benefit one is deriving out of misdeeds. Not only the officers of the company, but if any government official is involved in the offense or adopting any delaying technique or protecting corporate manager, must also be held responsible and punished. Financial reporting system must be transparent and simple to the extent possible. The law can not dictate every thing at all time; it is the spirit of the corporate managers and their high ethical standards to adhere to all rules with the spirit to protect interest of shareholders and balancing justice amongst all stakeholders.

Financial Reporting:

Accounting Standards should be reviewed in the light of new development (technical, financial, legal, economical and corporate frauds) and international practices. The Accounting Standards should harmonize not only with international standards but with other applicable corporate and taxation legislation. To incorporate social justice, environmental issues, economic reforms and social context, vis-à-vis to make professional managers and directors more accountable to shareholders & other stakeholders Accounting Standards should narrow the choice of alternative accounting practices that make fair disclosure of accounting and financial information. In the light of above, it is suggested that fair disclosure, honest actions, independence, materiality and vision to sustainable development of corporation and society should be woven together with vibrant but precise Accounting Standards. Knowledge dissemination about financial reporting should be cluster wise, e.g. large & small companies, manufacturing & service companies, sector wise companies, accountants of urban & rural area, auditors of small branches, zonal offices and regional offices, individual shareholders, mutual funds & other investors.

Vigilance:

There must be continuous vigilance over all public sectors, family managed & widely held company by specialist team for each sector. There must be clear & identifiable authorities, which should be made accountable in case of failure and should take speedy & strict actions. Accountability for officers of company including any directors must be clearly defined and fixed for any deviation. Accountability for officers of government agencies must be clearly defined

and fixed for any failure in taking appropriate actions within reasonable time. Vigilance officers must be given training on how to identify & check frauds.

Cost of non-compliance:

The penalty & punishment should be deterrent and of higher amount depending upon the benefits reached to the culprits or loss to the investors. There must be provision of recovery of grabbed amount from the property created and transferred to any person or in any other form. There must be speedy disposal of disputes. Any investigation, prosecution and adjudication process must be speedy and within pre-determined time limits. The time limits must be prescribed to take actions and decide fate of the case. There must be coordination between different authorities working for different purposes to avoid overlapping roles and exchange inter-related information.

Corporate Governance norms:

There must be special corporate governance norms for family based business houses. Family based businesses should be made more transparent, accountable and subject to higher surveillance. There must be special corporate governance norms for public sector units whether listed or not. Public sector businesses should be made more transparent, accountable and subject to higher surveillance. Mandatory corporate governance norms must be framed for Public Sector companies. Corporate governance norms for Insurance, Banking & Electricity Company must be suitable specifically designed to suit the nature of business and its public importance.

Clause 49 should give wide powers to Audit Committee. Clause 49 should have penal provision in case of failure. Whistle blowers must be protected and promoted by compensating if information is correct & useful. Companies should issue formal letters of appointment to Non-Executive Directors (NEDs) and Independent Directors as is done by them while appointing employees and Executive Directors. Such a formal letter should form a part of the disclosure to shareholders at the time of the ratification of his/her appointment or re-appointment to the Board.

The offices of chairman of the board and chief executive officer should be separate. The companies may have a Nomination Committee comprised of a majority of Independent Directors, including its Chairman. A separate section in the Annual Report should outline the

guidelines being followed by the Nomination Committee and the role and work done by it during the year under consideration. Independent Directors and NEDs should hold no more than seven directorships.

The Board should put in place a policy for specifying positive attributes of Independent Directors such as integrity, experience and expertise, foresight, managerial qualities and ability to read and understand financial statements. Minority shareholders should be empowered, allowed to appoint or endorse Independent Director/s. Disclosure about such policy should be made by the Board in its report to the shareholders. Such a policy may be subject to approval by shareholders. All Independent Directors should provide a detailed Certificate of Independence at the time of their appointment, and thereafter annually. Independent Directors should be restricted to six-year terms. They must leave for three years before serving another term, and they may not serve more than three tenures for a company. Independent Directors should have the ability to meet with managers and should have access to information.

NEDs should be paid either a fixed fee or a percentage of profits. Whichever payment method is elected should apply to all NEDs. NEDs paid with stock-options should hold onto those options for three years after leaving the board. Independent Directors should not be paid with stock options or profit-based commission. The Remuneration Committee should have at least three members with the majority of NEDs, and at least one Independent Director. Their decisions should be made available in the Annual Report.

Educating stakeholders:

Rule written in the book does not work effectively, unless the main actors are aware about their rights. Directors and investors are the main actors for whom the corporate governance norms are established. The Board should provide training for the directors. The Board should enable quality decision-making by giving the members timely access to information. The Board should put in systems of risk management and review them every six months. The Board should review its own performance annually and state its methods in its Annual Report. The Board should put in a system to ensure compliance with the law, which should be reviewed annually. All agenda items should be assessed for its impact on minority shareholders. Ministry of Corporate Affairs should

create an environment of learning for the shareholders by casting responsibility on companies to ensure dissemination of knowledge and ensure the following:

Basic shareholder rights include the right to:

a) Secure methods of ownership registration;
b) Convey or transfer shares;
c) Obtain relevant and material information on a timely and regular basis;
d) Participate and vote in general shareholder meetings;
e) Elect and remove members of the board; and
f) Share in the profits of the corporation.

Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:

a) Amendments to the statutes, or articles of incorporation or similar governing documents of the company;
b) The authorization of additional shares; and
c) Extraordinary transactions, including the transfer of all or substantially all assets that in effect result in the sale of the company.

Shareholders must be given opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures that govern general shareholder meetings:

a) Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.
b) Shareholders should have the opportunity to ask questions to the board, including questions relating to the annual external audit, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.
c) Effective shareholder participation in key corporate governance decisions such as the nomination and election of board members should be facilitated.

d) Shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.
e) Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

Grievance Handling:

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, governance of the company and authority to whom any deviation can be reported. Last but not least, there must be single window system to receive and monitor all type of complaints related to any company. The single window should send complains to concerned authority. As depicted in Annexure-3, currently, there are different authorities for different type of complain and different type of companies, resulting into confusion in the mind of the common citizen.

Investigation, prosecution success rate & timeliness:

If we consider more accountability of directors of the listed company compared to closely held company, handling of grievances by SEBI is not satisfactory. During the period 2011-12, the regulator received 46,548 complains from the investors and have disposed 53,841 complains while 26,66,695 complaints are pending for disposal. Of the 154 case of investigation, regulator could finish 74. Out of 980 prosecutions, court could decide 240 cases and 131 convictions but 44 dismissed. It shows poor home work of regulator. At the appeal stage, 90 were dismissed out of 247 appeals filed with the higher adjudicating authority. 2 cases are old as of 1997-98. The record of 1999-2000 is also not convincing, where 91 cases were dismissed out of 164 complains filed with the adjudicating authority. The regulators should review the whole mechanism to improve success rate and in timely manner, before the investor lose the confidence in the system.

Annexure-1

Stakeholders rights in Corporate Governance

No.	Levers/ Stakeholder	Preventive	Curative	Punitive
1	Members/ Shareholders	Appointment of Directors/ Auditors on the basis of quality of appointee Active participation in meetings of the members	Reversal of Board decision Removal of Directors/Auditors Law suits by minority	Insolvency litigation
2	Independent Directors	Independent, vigilant & active in Board decisions, raise dissent voice	Vote against resolution	Resignation
3	Nomination Committee	Independence & professionalism in approach	Dissent vote	Resignation
4	Audit Committee	Independence & professionalism in approach	Dissent vote	Resignation
5	Auditors	Proper control & check, Independent & thorough audit through professional trained team	Seek management clarification	Qualified audit report
6	Registrar of Companies/ Ministry of Corporate Affairs	Regular inspections	Imposing penalty in case of non-compliance	File prosecution
7	Creditors	Appointing Nominee Directors	Stop extending credit limit	Withdraw credit facilities
8	SEBI	Strict compliance Vigilance on insider trading & protection of investors interest	Imposing penalty in case of non-compliance	Filing court case
9	Stock Exchanges	Studious monitoring on insider trading & protection of investors interest	Imposing penalty in case of non-compliance	De-listing from the stock exchange
10	MRTPC	Strict compliance in corporate trade practices	Imposing penalty in case of non-compliance	Grant injunction or give directives
11	Competition Commission	Strict compliance in merger, acquisition & takeovers	Imposing penalty in case of non-compliance	Injunction and penalty
12	ICAI	Guidelines to auditors	Peer review of auditor	Disciplinary actions against erring auditor
13	Consumer Forum	N/A	Speedy disposal of consumer application	Compensation order
14	Civil & District Courts	N/A	Fair and speedy trial, Path breaking judgments	
15	High Court	N/A		
16	Supreme Court	N/A		

Annexure-2
Legal Framework for Corporate Governance in India

The Legislation	Provision	Penalty	Note
The Constitutional Law of India	Article 38 & 39, The government is directed that the ownership & control of the material resources are so distributed as to conform to the common good & operation of the economic system does not result into concentration of wealth & means of production to the common detriment	It is source of legislation to enact rules to conform directions given by constitution and by such rules, if fundamental right of a person is violated, courts give priority for common interest	There is no direct bearing on corporate governance issues or on any person
Companies Act, 1956	Sec. 59, If any prospectus is issued in contravention of section 57 or 58, the company, and every person, who is knowingly a party to the issue thereof, shall be punishable with fine which may extend to fifty thousand rupees	Punishable with imprisonment for a term which may extend to five years, or with fine which may extend to one hundred thousand rupees or with both	
	Sec. 63, Criminal liability for misstatements in prospectus, Where a prospectus issued includes any untrue statement, every person who authorized the issue of the prospectus	Punishable with imprisonment for a term which may extend to one/two year, or with fine, or with both	
	Sec. 68, Penalty for fraudulently inducing persons to invest money		
	Sec. 105, Penalty for concealing name of creditor, etc.		
	Sec. 162 provides penalty for contravention of not filing annual return & statement as prescribed	Punishable with fine which may extend to five hundred rupees for every day during which the default continues	
	Sec. 211 (3A) Every profit and loss account and balance sheet of the company shall comply with the accounting standards. (3B) Where the profit and loss account and the balance sheet of the company do not comply with the accounting standards, such companies shall disclose in its profit and loss account and balance sheet, (a) the deviation from the accounting standards; (b) the reasons for such deviation; and (c) the financial effect, if any, arising due to such deviation.	The statutory auditors are required to make qualification in their report in case any item is treated differently from the prescribed Accounting Standard. In addition to this Section 227(3)(d) of Companies Act, 1956 requires an auditor to report whether, in his opinion, the profit and loss account and balance sheet are complied with the accounting	

	Section 217 sub section (2AA) inserted by the Companies Amendment Act, 2000 states that The Board's report shall also include a Directors' Responsibility Statement indicating therein (1) that in preparation of annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departure	standards referred to in Section 211(3C) of Companies Act, 1956.	
	Sec. 225 deals with Statutory Audit of a company, company require to take certificate of auditor that certify financial statement as true & fair Auditor ensures financial statement is the result of financial transaction recorded and reported as per GAAP Sec. 232 provides penalty for not complying with preparing, presenting, submitting/filing audit report as prescribed u/s 225-231	The company, and every officer of the company who is in default, shall be punishable with fine which may extend to five thousand rupees	
	Sec. 279 prescribe penalty for holding directorship in more number of companies than prescribed	For each additional company in which he is director, Rs. 50000	
	Sec. 297 prescribe taking sanction of the Board of company if a director has interest in certain contract with the company Sec 299 provide responsibility of a director to disclose his interest in the contract with the company Sec. 300 states that the interested director can not participate or vote in Board's proceedings	Interested director can not participate in the voting in Board meeting for the purpose	
	Sec. 371 prescribes penalty for contravention of section 369 (Loans to managing agent), 370 (Loans, etc., to companies under the same management) or 370A, pertaining to intra-company loan or borrowing or creating liabilities like guarantee etc. Sec. 372 prescribes restriction on purchase of share etc. of any company by putting limits	Shall be punishable with fine which may extend to fifty thousand rupees or with simple imprisonment for a term which may extend to six months	
	Sec. 628, 629 prescribes penalty for false statements or false evidences	Punishable with imprisonment for a term, which may extend to two/seven years, and shall also be liable to fine.	
Insolvency Litigations	Winding up of company under sec 433 if company fails to pay its debt	Wind up of the company	
Security Contract Act,	Contracts of security trade in designated area, time, licensing, to deal with	Punishable with imprisonment for a term	

1956	recognized dealer, through stock exchange etc. Contract otherwise than this may be void	which may extend to one year, or with fine, or with both, authority is empowered to de-list a company	
Listing rules	Vetting of Prospectus, Protection of Investors, Insider Trading & Takeover rules, Public announcement of financial results and other information frequently	De-listing, seize or forefeet security deposits	
SEBI: Listing Agreement, Clause 49	Composition of Board (at least half should be non-executive, independent), Non executive directors' compensation and disclosures, board meetings (minimum 4 in a year), ceiling on director's membership in committees (maximum 10), ceiling chairman of committees (maximum 5), Audit Committee chairman should be independent director, 2/3rd members should independent & finance or accounting expert, applicability of code of conduct over Board members & top management, appointment of independent director as director of a subsidiary company, procedure to assess risks & disclosures thereof, CEO & CFO certification of financial statement, report on corporate governance compliance	Company may be de-listed from stock exchange	
SEBI: Takeover & Insider Trading, Shareholder Protection etc.	Four prone control/ penal provisions: Directions in investor interest, Adjudication Proceedings, Criminal Prosecution, Enquiry Proceedings Any person who, directly or indirectly, acquires or agrees to acquire shares or voting rights in the target company, or acquires or agrees to acquire control over the target company, either by himself or with any person acting in concert with the acquirer shall inform on crossing 5% or 10% or 14%, 54% and 74% inform Target Company and Stock Exchange within 2 days, Persons holding between 15% & 55%, to disclose purchase or sales aggregating to 2% or more, within 2 days to target company and the stock exchanges, open offer to purchase at least 20% of share at same price if holding cross 15%. Ban on using inside information for personal gain by way of purchase or sale securities for those who have access of internal information	Penalty of Rs. 100,000 per day of continuing violation, penalty is 3 to 5 time of undue gain or advantage, Violation may leads to freeze of transfer of share, voting rights, debarring from access to capital markets, forefeet escrow money, imprisonment up to 10 years and penalty of Rs. 2.5 million in criminal offenses	
Accounting	• AS-1 Disclosure of Accounting	Clause (6) Part I, Second	

Standards (AS) issued by ICAI (Institute of Chartered Accountants of India)	Policies • AS-14 Accounting for Amalgamations • AS-17 Segment Reporting • AS -18 Related Party Disclosures • AS-21 Consolidated Financial Statements • AS-23 Accounting for Investments in Associates in Consolidated Financial Statements • AS-27 Financial Reporting of Interests in Joint Ventures • AS-30, 31, 32 Accounting of Financial Instruments Sec. 227 (3d) whether, in opinion of the auditor, the profit and loss account and balance-sheet comply with the accounting standards referred to in sub-section (3C) of section 211; he may qualify his report and note observations or comments of the auditors which have any adverse effect on the functioning of the company	Schedule of the Chartered Accountants Act, 1949, provides that, failure of an auditor to report a known material mis-statement in the financial statements of a company, with which he is concerned in a professional capacity, shall be deemed to be 'professional misconduct' ICAI may tale action against auditor only	
Indian Penal Code	Sec. 120B (Criminal conspiracy) 406, 409, 420, 468, 471, 477A relating to fraud, cheating public, creating false documents, duping money etc.	Imprisonment up to 10 years	
Income Tax Act 1961	Regulations (2002) contained the mechanism to ensure that income arising out of international transactions between related parties (associated enterprises) is computed on the basis of arm's length.	Authorizes the Assessing Officer to refer the process of determination of arm's length price to the competent authority for transfer pricing leads to reassessment	

Annexure-3
Regulators/Authorities to approach for other type of complaints

Grievances pertaining to following issues	**Regulator**
Market Manipulation Price Rigging Capital "Issue" related Manipulation Insider Trading Takeovers	Security Exchange Board of India www.**sebi**.gov.in/
Banks deposits and banking Fixed Deposits with Non Banking Financial Companies (NBFCs) and other matters pertaining to NBFCs Primary Dealers	Reserve Bank of India (RBI) http://www.rbi.org.in
Fixed Deposits with manufacturing companies Unlisted companies Mismanagement of companies, financial performance of the company, Annual General Meeting, Annual Report, minority shareholders interest, non receipt of preferential allotment shares, etc. and corporate actions as per the court order such as mergers, amalgamation, reduction of share capital/par value, etc. Nidhi Companies	Ministry of Corporate Affairs (MCA) http://www.mca.gov.in
Insurance Companies Brokers Agents Insurance products and Service	Insurance Regulatory and Development Authority of India (IRDA) http://www.irdaindia.org
Commodities	Forward Markets Commission (FMC) http://www.fmc.gov.in
Pension fund	Pension Fund Regulatory and Development Authority (PFRDA) http://www.pfrda.org.in
Monopoly and anti competitive practices	Competition Commission of India (CCI) http://www.cci.gov.in
Chit Funds	Registrars of Chit Funds of the concerned State
Housing Finance Companies	National Housing Bank (NHB) www.nhb.org.in

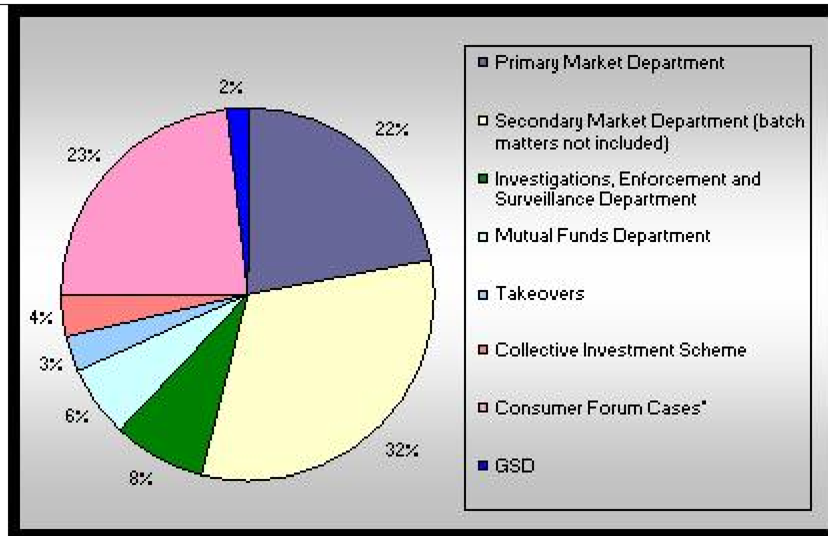
Annexure-4

Prosecution launched by SEBI and decided cases during 2011-12

Nature of Prosecution Launched	**Number of Cases**
Securities and Exchange Board of India Act, 1992 (SEBI Act)	980
SEBI Act & Securities Contracts (Regulation) Act, 1956 (SCRA)	91
SEBI Act, SCRA & Companies Act	1
SEBI Act & Companies Act	1
SEBI Act & Indian Penal Code	5
Companies Act, 1956	70
Securities Contracts (Regulation) Act, 1956	5
Depositories Act, 1996	14
Indian Penal Code	8
Total prosecution launched	**1,175**
Cases decided by court	**240**
Conviction	131
Compounded	58
Abated	4
Dismissed	44
Withdrawn	3
Source: SEBI Annual Report	

Annexure-5
Status and rate of litigation decision where SEBI was a Party

Sr. No.	**Subject Matter**	**1999-2000**		
		Cases Filed	Cases Dismissed	Cases Allowed
1	Primary Market Department	36	37	0
2	Secondary Market Department (batch matters not included)	53	18	0
3	Investigations, Enforcement and Surveillance Department	13	07	0
4	Mutual Funds Department	10	05	0
5	Takeovers	05	02	0
6	Collective Investment Scheme	06	16	0
7	Consumer Forum Cases*	38	16	0
8	GSD	03	0	0
	Total	**164**	**91**	**0**
Source: SEBI				



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Abbreviations & Glossary:

BSE – Bombay Stock Exchange
CCI – Competition Commission of India
CFO – Chief Financial Officer
CEO – Chief Executive Officer
DCA - Department of Company Affairs
GDP – Gross Domestic Product
ICAI – Institute of Chartered Accountants of India
OWC – Other Widely Held Company (other than FBC & PSU)
PSU – Public Sector Unit (where 50% or more share is held by one or more government)
RBI – Reserve Bank of India
ROC – Registrar of Companies
SEBI – Security Exchange Board of India
Widely Held Company – as defined by Income Tax Act 1961