

Corporate Governance : The Buzz Word

- Saket Sikri *

“Self regulation is important, but it’s not enough. Government cannot remove risk from investment - I know that- or change for the market but government can do more to promote transparency and ensure that risks are honest. And government can ensure that those who breach the trust of American people are punished”¹.

The recent Enron debacle which exposed the inherent weaknesses of the corporate governance system of the United States was the largest of its kind in the history of America. This bankruptcy case has hurt thousands of innocent men especially employees and pensioners who have seen their jobs and savings wiped out. This scandal has hurt the reputations of many good and honest companies. Not only has it hurt the stock market, but also millions of investing people. With a view to strengthen the corporate governance system in America subsequent to the Enron disaster the Congress passed *The Sarbanes Oxley Act*². This legislation imposed duties not only on the public companies but also on their executives, directors, auditors, administrators, attorneys and securities analysts. In addition to this it set new standards for auditor independence and established a regulatory system for the audit profession. Further it provided the securities and the exchange commission with more authority and resources. The act also enlarged the scope of criminal and civil liability in the securities area. The post Enron scenario has clearly established need for the governments to have a stronger and stricter corporate governance regime. The American Congress has made a new beginning in this direction by passing this legislation. This has made one point clear that the corporates and the professionals have to meet the expectations of the stakeholders, the government and the regulatory authorities. In order to avoid such a disaster and to ensure transparency and disclosure it is imperative that the governments should establish a strong and a powerful corporate governance regime.

CORPORATE GOVERNANCE: THE CONCEPT

Corporate governance in the words of Justice Venkatchalliah,³ is a ‘*new buzz word*’ in corporate jargon. It is a phrase which implies transparency of the management in business and industry. Corporate governance is a system whereby the companies are directed and controlled⁴. It includes the set of policies and procedures which a company adopts for achieving its objectives. Corporate governance encompasses the entire mechanism of the functioning of a company and attempts to put in place a system of checks and balances between the shareholders, directors, auditors and the management.⁵ In its normative sense, it prescribes a code of corporate conduct in relation to the stakeholders both external as well as internal. Therefore corporate governance is a system whereby the companies can be controlled and administered, besides ensuring transparency it is a mechanism which keeps a check and control over the corporates dealings, with a prime objective of ensuring accountability of these companies with those directly involved. The Corporate governance systems have often evolved in response to corporate failures. The first well-documented failure of governance was that of the South Sea Bubble in the 1700s which brought about a revolution in the business laws and practices in the United Kingdom. Likewise after the 1929 stock market crash the securities laws of the United States were amended to avoid such a disaster. There is no scarcity of such corporate shambles the recent Enron debacle⁶ which led to the passing of *The Sarbanes Oxley Act*⁷ is a classic example. The history of corporate governance is punctuated by a number of such corporate scandals. Whenever there is a corporate breakdown it exposes the weaknesses of the existing system, which calls for change.

What precisely constitutes the concept of corporate governance is still debatable Is it a new strategy or practice for business, or is it a therapy for mismanaged companies? Does it involve an internal transformation by the companies, or is there a need of a new environment for corporate business? There cannot be an exact answer to this question, as it may not be possible to lay down a foolproof system whereby these corporations can be governed so that such debacle could be avoided in future. However, what can be achieved is a system which ensures a level of transparency and disclosure for these companies or a set of norms to be laid down by the government and regulatory authorities to be followed by the business groups having public dealing.

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CORPORATE GOVERNANCE : A GLOBAL ISSUE

The issue of corporate governance is focal point of corporate culture, strategy and operations. Good governance enables the companies to effectively compete, at both national as well as international level. The need for having an effective mechanism for controlling the companies came about when a number of well-published corporate failures were noticed, it became necessary for the governments to interfere with the policy of '*laissez faire*'⁸. It became imperative for these governments to ensure that the public money which has been invested in these companies is not misused if the risk factor could not completely be removed. Moreso when it was seen that even reputed companies were involving themselves in such malpractices and were playing fraud upon their shareholders. Efforts to articulate the standards of corporate governance began in the countries like United States and the United Kingdom when a number of corporate scandals were noticed. Many senior managers of reputed and well known companies had abused the powers vested with them to further their own ends by indulging in illegal accounting practices. A notable case was that of Robert Maxwell and his alleged use of pension money to fund the business. The Polly Peck Plc company is another example where the senior Directors were convicted on account of false accounting. Deficiencies in the existing accounting standards became evident. These were the reasons which necessitated the British government to commission a working group chaired by Sir Adrian Cadbury⁹, to look into these matters and suggest norms and practices for effective governance. The working group set up by the government gave its report in May, 1992. The *Cadbury Code*¹⁰ in the United Kingdom concentrated on the composition and responsibilities of the board and formation of its subcommittees, i.e. it suggested the inclusion of significant number of competent, experienced and independent directors on the board. In addition to this, the Code also proposed the appointment of three subcommittees of the board one for fixing management compensation structure second for appointment or nomination of executive and non executive directors on the board, and the third an audit committee comprising of wholly non-executive directors. It also emphasizes the duty of the board of directors. Further, it suggested the creation of two posts, one of the chairman and the other of the chief executive. Apart from mentioning the duties of the board it also suggested that the listed companies should publish full financial statements annually and half yearly reports. Finally it mentioned that both the shareholders and the directors should make efforts for enhancing effectiveness of the general meetings and accountability.

The appointment of this Committee was perhaps the first effective measure taken by a government to examine this issue. As we have seen from the Report, it makes it clear that the Code emphasized the need of having a responsible board which is both accountable and transparent in its functioning. Dr. P. Asthana¹¹ on board functioning remarks:-

“The board should have a core group of excellent, professional acclaimed non-executive directors who understand their dual role: of evaluating the proposals put by the management and of discharging their fiduciary responsibilities towards the company’s shareholders as well as creditors”.

The *Cadbury committee*¹² commenced the new phase which was marked by a great deal of research in the then nascent field of governance of the corporates or measures to ensure effective governance. This was followed by many such working groups which could look into the issues affecting governance and propose best practices for effective governance. Some of them are as under

*Mervyn E. Kings Committee report on corporate governance*¹³

This committee also laid stress on the functioning of the board and the inclusion of non- executive directors as well as separation of the post, i.e., two posts, one of the C.E.O¹⁴ and other of the chairman. It also proposed that each company should have accounting standards in line with international standards.

*Greenburry Committee on director’s remuneration*¹⁵

As the name suggests, this Committee was set up to look into the remuneration of the directors of the board. It recommended setting up of a remuneration committee of non-executive directors to determine company’s policy

on executive remuneration. The committee was also to decide various types of allowances and bonuses the directors are entitled.

Similarly there have many other committees and working groups set up by governments and each of them has given recommendations emphasizing the need of having an effective board, and has suggested the composition of the board and their accountability towards the shareholders. Further they also proposed for the formation of an audit committee having independent members. In addition to this they demanded the safeguarding the rights of the shareholders¹⁶. Some of these committees are:

1. *CalPERS Global Corporate Governance Principles*¹⁷
2. *The business round table*¹⁸
3. *Statement on Corporate Governance*¹⁹
4. *Hampel Committee on Corporate Governance*²⁰
5. *Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*²¹
6. *OECD Principles of Corporate Governance*²²
7. *CACG Principles of Corporate Governance in Commonwealth*²³

Chief feature of all these

Committee's reports is that they lay stress upon functioning and composition of the board. They emphasize the need for having transparency and accountability of the companies towards their shareholders. The perusal of the reports of these working groups set up by various governments or regulatory authorities, we come out with some codes effective governance. The most important of them is the *accountability of the board*, this forms an essential feature of good governance. Accountability of the board to the company and its shareholders is a basic principle of sound governance. It is the board's duty to act fairly with respect to all groups of shareholders, to deal fairly with stake holders and to assure compliance with laws. In addition to this *Disclosure and transparency*, of the companies' affairs is the corner stone of an effective governance system. Accurate information should be disclosed on all material matters +regarding the financial situation, performance, ownership, and governance of the company within a specified time. In addition to this it is imperative for a company to have independent audit company. *Right of shareholders* is perhaps one of the most important tenant good governance. The rights of the shareholders must include essential rights of transfer and registration of ownership of shares, receiving relevant and timely information on a regular basis about the company's affairs, in addition to this right of participation and voting in policy matters. *Equitable treatment of shareholders*, included as a right.

The need for having a strong and powerful mechanism did not end at this stage, there was a call was for having a forum which can monitor and lay down standards for this system. The step was taken by The World Bank and the OCED²⁴ when a memorandum of understanding was signed between them on June 21, 1999 to sponsor the *global corporate governance forum*. As per the understanding the forum was to provide for a rapid – response mechanism for coordinating and channeling practical technical assistance of specific constituent reforms above all, the forum was to mobilize local and international public and private sector expertise and resources to champion and advance corporate governance on a fast tract.

Interest in reform of corporate governance has subsequently spread to other countries. This has become a subject matter of a large number of committees, debates, seminars, workshops and conventions it is today a favorite topic for the able writers, learned speaks and legal as well as business luminaries. First, the OECD²⁵ where the equity investments were gaining importance began to address this issue. India too has shown a keen interest in studying this concept of governance, many erudite works have been put forth and many committees or working groups have been formulated to study the concept in detail. The author has made an attempt to put forth such works and recommendations of some of the committees in the next section.

CORPORATE GOVERNANCE : THE INDIAN SCENARIO

As we have seen, corporate governance had become or rather was becoming a ‘*buzz word*’ around the globe. However, the phrase remained alien to Indian context till 1993.

Dr.P.L. Sanjeeva Reddy²⁶ remarked:

“It came due to the fore to a spate of corporate scandals and fraudulent practices during the first flush of economic liberalization.”

The opening up of the Indian economy or the economic liberalization of India came about in the year 1991. Immediately after this shift in the economic policy, certain scams or commercial scandals were noticed. The first was a major security scam, the second one came about when the multinational companies started consolidating their shareholdings. The next one involved the vanishing companies of the 1993-94 and the fourth one was a large scale fraudulent and unfair trade practices by the capital market participants and the companies. These commercial debacles made the government, regulatory authorities, corporate sectors, and the financial institutions, realize the need of having a powerful corporate governance mechanism in India. Although it has been a much debated ‘*buzz word*’ but, it was in the year 1998 when measures began to take place in India. It started with the confederation of the Indian Industry (CII), framing a voluntary code of corporate governance. This was followed by the recommendations of the Kumara Mangalam Birla Committee set up by the Securities and the Exchange Board of India (SEBI). The committee in its report gave emphasis upon disclosure of the company’s affairs to its shareholders especially the pecuniary dealings of the directors with the company in its annual report; it further gave its recommendations on the composition of the board of directors and proposed for the inclusion of non-executive directors with fixed remuneration in the board. The working group set up by the SEBI, recommended for the constitution of an audit committee for a listed company and also mentioned its composition and functioning. Further it proposed for imposition of restrictions upon the directors for being members in other companies. In addition to this the committee also suggested that the management must disclose all important financial and commercial issues to the board. Towards the end, the working group set up by the SEBI proposed that each company should have separate section on corporate governance in its annual report. The setting up of this working group was the first step towards effective corporate governance in India. Majority of the recommendations of this committee are in *Para material* with that of the *Cadbury Code*²⁷, as both the reports mention in great detail about the functioning and composition of the board, disclosure and accountability towards the shareholders, and most importantly both the reports have laid emphasis on the composition of an independent audit committee. The recommendations of the Kumara Mangalam Birla committee were further culminated into the introduction of *clause 49*²⁸ of the standard listing agreement to be complied with by all listed companies within a stipulated time frame. This was followed by the Companies (Amendment) Act 2000, which introduced many additional grounds for the disqualification of the directors, also mentioned of formation of various independent audit committees. It was further introspected by an advisory group which was constituted by a standing committee on *international finance standards and codes* of the Reserve Bank of India under the chairmanship of Dr. Y.V. Reddy²⁹. The journey towards good governance was on, many changes and amendments were initiated in the existing set up. A large number of seminars, workshops, conventions and programs were devoted towards it. However, the Enron debacle involving a hand-in-glove relationship involving the auditor and the corporate client brought us back to the basics. The scam which involved the fall of the corporate giants in the United States like the WorldCom, Qwest, Global Crossing, Xerox, which led to the enactment of the *Sarbanes Oxley Act*³⁰, in America were some important factors which led to the Indian government in 2002, to appoint a committee under the chairmanship of Shri Naresh Chandra known as the Naresh Chandra committee to examine and recommend drastic amendments in the existing setup involving the auditor-client relationships and the role of the independent directors. Further in 2002 SEBI analyzed the statistic of compliance with the *clause 49*³¹ for the listed and felt that there was a need to look beyond the mere systems and procedures of if corporate governance was to be made effective in protecting the interest of the investors. SEBI therefore constituted a committee under the chairmanship of Mr. Narayanamurthy³² mandated the said committee to review the performance of corporate governance in India, and make appropriate recommendations. The Narayanamurthy Committee submitted its report on the 8th Feb 2003. The Committee included representatives from the stock exchanges, Chambers of Commerce and Industry, investor

associations and Professional bodies and debated on key issues and made recommendations as under: The mandatory recommendations of the Committee were: -

Audit Committees of Publicly Listed Companies should be required to review the following information mandatorily

- (i) Financial statements and draft audit report including quarterly / half yearly financial information.
- (ii) Management discussion and analysis of financial condition and results of operations.
- (iii) Reports relating to compliance with laws and to risk management.
- (iv) Management letter W letters of internal control weaknesses issued by statutory/internal auditors.
- (v) Records of related party transactions.

In regard to financial literacy of members of the Audit Committee the Committee makes mandatory recommendations to the effect that all audit committee members should be financially literate' and at least one member should have accounting or related financial management expertise. The term financially literate' means the ability to read and understand basic financial statements i.e., balance sheet, profit and loss account and statement of cash flows. A member will be considered to have accounting or related financial management expertise, if he or she possesses experience in finance or accounting or requisite professional certification or any other comparable experience or background which results in individual's financial sophistication including being or having been a chief executive officer, chief financial officer or other senior office with financial oversight responsibilities.

Disclosure of Accounting Treatment

In case a company has followed a treatment different from that prescribed in an accounting standard, companies should be given a reasonable period of time within which to cure the qualifications, by SEBI / Stock Exchanges. Mere explanations from companies may not be sufficient.

Audit Qualifications

Companies should be encouraged to move towards a regime of un-qualified financial statements. This recommendation which is non- mandatory should be reviewed at an appropriate juncture to determine whether the financial reporting climate is conducive towards a system of filing only un-qualified financial statements,

Basis for Related Party Transactions

A statement of all transactions with related parties including their bases should be placed before the independent audit committee for formal approval / ratification. If any transaction is not on arm's length basis, management should provide an explanation to the audit committee justifying the same. The term related party' shall have the same meaning as contained in the Accounting Standard 18, Related Party Transactions, issued by the ICAI.

Risk Management — Board Disclosure

Procedures should be in place to inform Board members about the risk assessment and minimization procedures. These procedures should be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

Management should place a report before the entire board of directors every quarter documenting the business risks faced by the company, measures to address and minimize such risks, and any limitations to the risk taking capacity of the corporation. This document should be formally approved by the Board.

Training of Board Members

Companies should be encouraged to train their Board members in the business model of the company as well as the risk profile of the business parameters of the company, their responsibilities as directors and the best ways to discharge them.

Use of Proceeds of IPO

Companies raising money through an IPO should disclose to the audit committee, the uses / applications of funds by major capital (capital expenditure, sales and marketing, working capital etc) on a quarterly basis.

On an annual basis, the company should prepare a statement of funds utilized for purposes other than those stated in the offer document / prospectus. The statement should be certified by the independent auditors of the company. The audit committee should make appropriate recommendations to the Board to take steps in this matter.

Written Code of Conduct for Executive Management

It should be obligatory for the Board of a company to lay down the code of conduct for all Board members and senior management of a company. The code of conduct shall be posted on the website of the company.

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

Senior Management' shall mean personnel of the company who are members of its management operating council (i.e., core management team excluding Board of Directors). This would comprise of all members of management one level below the executive directors.

Nominee Directors — Exclusion of nominee directors from the definition of independent directors

The committee recommends that there shall be no nominee directors where an institution wishes to appoint a director on the Board, such appointment should be made by the shareholders. An institutional director so appointed shall be subject to the same liabilities as any other director. Similarly, nominee of the Government on public sector companies shall be similarly elected and shall be subject to the same responsibilities and liabilities as other directors.

Non-executive directors Compensation — Limits on compensation paid to independent directors

All compensation paid non-executive directors may be fixed by the Board of Directors and should be approved by the shareholders in general meetings. Limits should be set for the maximum number of stock options that can be granted to non-executive directors in any financial year and in aggregate. The stock options granted to the non-executive directors shall vest after a period of at least one year from the date such non-executive director have retired from the Board of the company.

Companies should publicize their compensation philosophy and statement of entitled compensation in respect of non-executive directors in their annual report; together with the details of shares held including on an 'if-converted basis'. Non-executive directors should be required to disclose their stock holding (both own and held on beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment. This should accompany their notice of appointment.

Independent Directors - Definition

The committee has adopted the same definition of 'independent director' as formulated by the Naresh Chandra Committee.

The only item that does not find a place relates to the maximum period for which the person has been a director, independent or otherwise of the company for more than three terms of three years duration each.

Internal Policy on access to Audit Committees

Personnel who observe an unethical or improper practice (not necessarily a violation of law) should be able to approach the audit committee without necessarily informing their supervisors. Companies should take measures to ensure that this right of access is communicated to all employees through means of internal circulars etc. The employment and other personnel policies of the company shall contain provisions protecting 'whistle blowers' from unfair termination and other unfair prejudicial employment practices.

Whistle Blower Policy

Companies should annually affirm that they have not denied any personnel access to the audit committee of the company and that they have provided protection to whistle blower' from unfair termination and other unfair or prejudicial employment practices.

The appointment, removal and terms of remunerations of the chief internal auditor must be subject to review by the audit committee. Such affirmation shall form part of the Board's Report on corporate governance that is required to be prepared and submitted together with the annual report.

Subsidiary Companies — Audit Committee requirements

The provisions

relating to the composition of the Board of directors of the holding company should be made applicable to the composition of the Board of directors of the subsidiary company. At least one independent director on the board of the parent company shall be a director on the Board of the subsidiary company.

- α The audit committee of the parent company shall also review the financial statements, in particular the investment made by the subsidiary company.
- α The minutes of board meetings of the subsidiary company shall be placed for review at the Board meeting of the parent company.
- α The board's report of the parent company should state that they have reviewed the affairs of the subsidiary company also.

Evaluation of Board Performance — Mechanism for evaluation of non-executive Board Members

The Committee's recommendation in this regard is non-mandatory. The performance evaluation of non-executive directors should be by a peer group comprising the entire board or directors, excluding the director being evaluated. Peer group evaluation should be the mechanism to determine whether to extend / continue the terms of appointment of non-executive directors.

Analyst Reports — Disclosures in reports issued by Security Analysts

SEBI should make rules for disclosure in the report issued by a security analyst whether the company that is being written about is a client of the analyst's employer or an associate of the analysts' employer, and the nature of services rendered to such company, if any.

In the mean while many of the recommendations of the Naresh Chander committee found their acceptance in form of the Companies (Amendment) Bill 2003 which was introduced in the Parliament in may 2003. First the author has laid down the necessary recommendation of the working group and then has moved up to the amendment bill.

RECOMMENDATION OF NARESH CHANDRA COMMITTEE

The Department of Companies Affairs in the Ministry of Finance & Company Affairs appointed a High Level Committee, popularly known as Naresh Chandra Committee, to examine various corporate governance issues and to recommend change in the diverse areas such as (a) the statutory auditor-company relationship so as to further strengthen the professional nature of the interface, (b) the need, if any, for rotation of statutory audit firms or partners, (c) the procedure for appointment of auditors and determination of audit fees, (d) restrictions, if necessary on non-audit fees, (e) independence of auditing functions, (f) measures required to ensure that the management and companies actually present 'true and fair' statement of the financial affairs of companies, (g) the need to consider measures such as certification of accounts and financial statements by management and directors, (h) the necessity of having a transparent system of random scrutiny of audited accounts, (I) adequacy of regulation of chartered accountants, company secretaries and other similar oversight functionaries, (j) advantages, if any, of setting up an independent regulator similar to the Public Company Accounting oversight Board in the SOX Act, and if so, its constitution, and (k) the role of independent directors and how their independence and effectiveness can be ensured.

Needless to say that the terms of reference of the Committee lie at the heart of the corporate governance. At the outset, the Committee recognizes the fact that while the listed companies in India need to follow very stringent guidelines on corporate governance, which rank among some of the best in the world, there is a wide gap between prescription and practice. Another development which seems to have influenced the thinking of the Committee is

the passage of Sarbanes—Oxley Bill, popularly, called SOX in USA. This Act brought with its fundamental changes in virtually every area of corporate governance and particularly in the areas of auditor independence. Conflict of interest, corporate responsibility, enhanced financial disclosures and severe penalties for willful default by managers and auditors. Needless to say that the aforesaid legislative enactment was passed in the background of large scale financial failure and the auditing lacunae. The Enron Debacle of 2001, followed by large US Companies such as Worldcom, Quest, Global Crossing and the Collapse of the audit firm Anderson, are too familiar to be ignored.

After a good deal of deliberations and inter-action with the trade associations and professional bodies, the Committee made very significant recommendations for changes, inter alia, in the Companies Act. They are: -

Disqualification for Audit Assignments

The Committee recommends a list of disqualifications such as:

- (i) Prohibition of any direct financial interest in the audit client by the audit firm, its partners or members of the engagement team as well as their 'direct relation';
- (ii) Prohibition of receiving any loan and / or guarantee from or on behalf of the audit client;
- (iii) Prohibition of any business relationship with the audit client; (iv) Prohibition of any personal relationship. This would exclude any partner of the audit firm or member of the engagement team being a relative of any of the key officers of the client company, i.e., whole-time director, CEO, CFO, Company Secretary, Senior Manager belonging to the top two managerial levels etc.
- (v) Prohibition of service or cooling off period. Any partner or member of the engagement team of an audit firm who wants to join an audit client or any key officer of the client company wanting to join the audit firm. They will be allowed to do after the cooling off period of two years from the respective dates of involvements;
- (vi) Prohibition of undue independence on an audit client. This is measured with reference to the audit fees received from the audit client. Such a fee should not exceed 25% of the total revenues of the audit firm from any one client and its subsidiaries and affiliates.

The following services shall not be provided by an audit firm to an audit client

- (i) Accounting and book keeping services relating to the accounting records or financial statements of the audit client;
- (ii) Internal audit services;
- (iii) Financial information systems design and implementation including services related to IT Systems for preparing financial or management accounts and information flows of a company;
- (iv) Actuarial services;
- (v) Broker, dealer, investment adviser or investment banking services;
- (vi) Outsourced financial services;
- (vii) Management functions including provision of temporary staff to audit clients; staff for the audit client;
- (viii) Valuation services and fairness opinion.

In case the firm undertakes any service other than audit or the prohibited services listed above,, it should be done only with the approval of the audit committee.

Auditor's disclosure of contingent liabilities

Management should provide a clear description in plain English of each material liability and its risks. This should be followed by the auditor's clearly worded comments on the management view and highlighted in the significant accounting policies and notes on accounts as well as in the auditor's report, where necessary.

Auditor's Disclosure of Qualifications and Consequent Action

It should be mandatory for the audit firm to send separately a copy of the qualified report to the ROC, the SEBI and the Principal Stock-Exchange, with a copy of the letter sent to the management of the company.

Management's Certification in the event of Auditor's Replacement

Committee recommends that section 225 of the Companies Act should be amended to require a special resolution of shareholders in case an auditor, while being eligible for re-appointment, is sought to be replaced. The explanatory statement should disclose the management's reasons for such a replacement. The Audit Committee will have to verify that the explanatory statement is "true and fair".

Auditors' Annual Certification of Independence

Before agreeing to be appointed, the audit firm must submit a certificate of independence to the Audit Committee or the Board of Directors of the client company to the effect that (i) the firm together with the consulting and specialized services affiliates, subsidiaries and associate companies are independent and have arm's length relationship with the client company. It should also be stated that the firm has not engaged in any non-audit services and are not disqualified from audit assignment.

In the event of any inadvertent violations, the audit firm should bring these to the notice of the Audit Committee or the board, which will take prompt action to address the cause restore independence at the earliest.

Appointment of Auditors

The Audit Committee should be the first point of reference regarding appointment of auditors. To discharge this fiduciary responsibility, the Committee should discuss the annual work programme, review the independence of the audit firm and recommend to the board, with reasons, either the appointment, re-appointment and removal of the external director, along with the annual audit remuneration. Government companies may be exempted from this requirement.

CEO and CFO Certification of Annual Audited Accounts

In the case of all listed companies and public limited companies whose paid up capital and free reserves exceeds Rs.10/- crores or turnover of Rs.501- crores, there should be a certification by the CEO (either the Executive Director or the Managing Director) and the CFO (whole-time Finance Director or otherwise) to the effect: -

- They have reviewed the balance sheet and profit and loss account and all its schedules and notes on accounts, the cash flow statement and the Directors' Report;
- These statements do not contain any material untrue statement or omit any material fact nor do they contain statements that might be misleading;
- These statements together represent a true and fair picture of the financial and operational state of the company and are in compliance with the existing accounting standards and / or applicable laws regulations;
- They are responsible for establishing and maintaining internal controls which have been designed to ensure that all material information is periodically made known to them, and have evaluated the effectiveness of internal control systems of the company.
- They have disclosed to the auditors and the Audit committee deficiencies in the design or operation of internal controls, instances of significant fraud, if any, involving management or employees having a significant role in the company's internal control systems, significant changes in internal control and / or accounting policies during the year under review and they will return to the company that part of any bonus or incentive or equity bases compensation which was inflated on account of such errors as decided by the Audit Committee.

Auditing the Auditors

There should be established, with legislative support, three independent Quality Review Boards (ORB) one each for the ICAI, the ICSI and ICWAI to periodically examine and review the quality of audit, secretarial and cost accounting firms and pass judgements and comments on the quality and sufficiency of systems, infrastructure and practices. The composition of the Committee and other details are also dealt with by the Committee in its report.

Independent Directors

In defining an independent director of a company, the committee has recommended that he is a non-executive director who, apart from receiving directors' remuneration, does not have any material pecuniary relationship or transactions with the company, its promoters, its senior management or its holding company, its subsidiary and associated companies. Such a director: -

- (i) is not related to promoters or management at the board level, or one level below the board (spouse and dependent parents, children or siblings);
- (ii) has not been an executive of the company in the last three years;
- (iii) is not a partner or an executive of the statutory auditing firm, the internal audit firm that are associated with the company and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal
- (iv) is not a significant supplier, vendor or customer of the company
- (v) is not a substantial shareholder of the company i.e., owning two percent or more of the block of voting shares;
- (vi) has not been a director, independent or otherwise, of the company for more than three terms of three years (not exceeding nine years in any case);
- (vii) any employee, executive director or nominee of any bank, financial institution, corporations or trustees of debentures and bond holders, who is normally called 'nominee director' will be excluded from the pool of directors in the determination of the number of independent directors. Such a director will not feature either in the numerator or the denominator.

The Committee recommends that the above criteria should be made applicable for all listed companies and unlisted public limited companies with a paid up share capital and free surplus of Rs.10/- crores and above or turnover of Rs.50/- crores and above with effect from the financial year beginning 2003. The Committee also recommends that independent directors must have adequate presence and strength on the Board. The percentage of independent directors should not be less than 50% of the board of directors. However, this requirement will not apply to unlisted public companies which have no more than 50 shareholders and which are without debt of any kind from the public, banks or financial institutions, so long as they do not change their character.

Minimum Board Size of Listed Companies

The Committee recommends that the minimum size of board of all listed companies and unlisted public limited companies with a paid up share capital and free reserves of Rs.10/- crores and above or turnover of Rs.50/- crores and above should be 7 (seven), of which 4 (four) should be independent directors. However, this will not apply to unlisted public companies which have no more 50 shareholders and which are without debt of any kind from the public, banks or financial institutions as long as they do not change their character and unlisted subsidiaries of listed companies. The Committee also recommends that duration of Board / Committee meetings should be disclosed.

Teleconferencing and Video Conferencing

If a director cannot be physically present but wants to participate in the board proceedings and its Committees then a minute and signed proceedings of a teleconference or video conference should constitute proof of his or her participation. Accordingly, this should be treated as presence in the meeting/s. However, minutes of all such meetings should be signed and confirmed by the directors who has/have attended the meeting through video conferencing.

The Committee also recommends that the aforesaid category of public companies should transmit all press release and presentation to analysts to all board members.

Audit Committee should consist exclusively of Independent Directors

This should apply to all listed and unlisted public companies with a paid up share capital and free reserves of Rs.10/- crores and more or turnover of Rs.50/- crores and more. However, this will not apply to unlisted public companies which have no more than 50 shareholders and which are without debt of any kind from the public, banks or financial institutions as long as they do not change their firms character and unlisted subsidiaries of listed companies. The role and functions that an Audit Committee is suppose to discharge in a company should be clearly laid out in an Audit Committee charter.

The Audit Committee should disclose the names of members of the Audit Committee, the dates and frequency of meetings. The Chairman of the Committee must certify whether and to what extent each of the functions listed in the charter were discharged in the course of the year. This will serve as the Committee's action taken report to the Shareholders.

The disclosure should also give a report of the tasks performed by the Committee, including, among others, the Committee's views on the adequacy of internal control systems, perceptions of risks and in the event of any disqualification, why the Audit Committee accepted and recommended the financial statements with qualifications. The statement should also certify whether the Committee met with the statutory and internal auditors of the company without the presence of management and whether such meetings revealed materially significant issues or risks.

Remuneration of Non-executive Directors

The statutory limit on sitting fee should be reviewed, although ideally it should be a matter to be resolved between the management and the shareholders. However, loss-making companies should be permitted by DCA to pay special fee to any independent director, subject to reasonable caps. The present provisions relating to stock options and one percent commission on net profits, is adequate and does not, at present, need any revision.

Exempting Non-executive Directors form Certain Liabilities

Time has come to insert provisions in the definition chapter of certain Acts to specifically exempt non-executive directors and independent directors from criminal and civil liabilities. An illustrative lists of these Acts are the Companies Act, Negotiable Instruments Act, Providend Fund Act, ESI Act, Factories Act, Industrial Dispute Act and the Electricity Supply Act. Independent directors should also be indemnified of the costs of litigation etc.

Training of Independent Directors

DCA should encourage institutions of prominence including their proposed centre for corporate excellence to have regular training programmers for independent directors in framing the programmes and for other preparatory work. Funding could possibly come IEPE

All independent directors should be required to attend at least one such training course before assuming responsibilities as an independent director. Considering that enough programmes might not be available during initial years, such director should undergo training within one year, after becoming an independent director. An untrained independent director should be disqualified under Section 274 (1) (g) of the Companies Act. As the training institutions and programmes might not be available in the initial years, the requirement of training maybe introduced in a phased manner. There should be a trainee appraisal' system to judge the quality of the programme.,

Corporate Serious Fraud Office (CSFO)

This should be set up in the DCA with specialists inducted on the basis of transfer / deputation and on special term contracts. This should be a multi-disciplinary team that not only covers the fraud, but is also able to

direct and supervise prosecutions under various economic legislations through appropriate agencies. There should be a task force constituted for each case under a designated team leader. The Cabinet Secretary should directly oversee the appointments to and functioning of this office and co-ordinate the work of concerned departments and agencies.

In recommending the constitution of Serious Fraud Office, the Committee is also of the opinion that the Principle of ill-gotten gains must be disgorged from the wrongful gainer needs to be enshrined in the Companies Act.

The Committee also stated that good corporate governance is good business because it inspires investors' confidence, which is so essential to attracting capital.

THE COMPANIES (AMENDMENT) BILL, 2003

A close look at the amendments proposed in the Bill reveals that the changes proposed are based upon the recommendations made by the Naresh Chandra Committee and/or Narayana Murthy Committee. Both the committees have done excellent job and they deserve to be complimented on the fine tuning done by them in the matter of new norms of governance.

In particular, clauses 99, 102, 104, 106, 107, 112, 118, 119, 132, 136, 137, 155, 157 and 174 of the Amendment Bill can be traced to the recommendations of Naresh Chandra Committee.

EMERGING TREND

The recommendations of both the Committees are far reaching in terms of new norms of governance. The recommendations are going to affect both the managements of corporate organizations and the audit firms. Some of the proposed changes are : -

(a) Re-classification of Public Companies into three categories. The first category relates to the public company having a paid up share capital and free reserves of Rs.5/- crores or more (Scaled down from Rs.10/- crores recommended by Naresh Chandra Committee) or a turnover of Rs.50/- crores or more. Such companies should have a minimum number of 7 (seven) directors, out of which majority of directors shall be independent directors (section 252). Before this is implemented, the Government has to make sure that enough number of independent directors are available. Emphasis has to be on the persons having professional qualifications and exposure to industry.

(b) Disqualification for being appointed as an independent director (section 252 A). The list is too long and envisions an ideal situation. At this rate, it would be difficult for the corporate bodies to find suitable persons to be appointed as independent directors.

Some of the disqualifications are too harsh. The Committee has not spelt out why all these disqualifications are necessary, particularly a customer of the goods or services. It also gives an impression that a supplier or vendor of goods or services is hand in glove with the management of companies. This may not correspond to reality. In all cases, there may not be any nexus. Similarly, a person holding 2% or more shares in a company is disqualified. The Committee agrees that the shareholders are the owners of the company and they do not stand in adversarial position vis-à-vis the board. By virtue of his stake in the company, he expects the company to prosper so that he may get a good return on his investment and he may contribute to this, by being in the Board. Why such a person be disqualified?

The nominee directors are worse off in the new scheme of things. What prevents them from being considered as an independent director, if they agree to function as a director of the company? Liability of being a director of a company should not bother them, as the Bill proposes to exempt independent directors from Criminal / Civil liability. This measure has also been recommended by both the committees aforesaid.

A lot more restrictions are proposed to be improved on the audit firms. The Committee has recommended disqualification for audit assignments. One of the disqualifications relates to prohibition of undue dependence on an audit client. This is proposed to be measured with reference to the audit fee received from an audit client, and its subsidiary and affiliates. This should not exceed 25% of the total revenues of the audit firm, not being less than Rs.15/- lakhs per annum. This appears to be an artificial restriction. While audit firms have to maintain their independence' in the matter of audit assignment, and if this is achieved to the desired extent, why place restrictions on the quantum of fee? This is a matter, which ICAI should decide by laying down broad guidelines for charging audit fees, with reference to the audit work involved or on the basis of turnover.

It is heartening to note that the DCA representatives have assured trade and industry organization / professional bodies that they will have a fresh look at the concept of independent director, as envisioned in the Bill and the numerous restrictions proposed to be placed on the audit firms.

WHAT THE FUTURE HOLDS FOR THE CORPORATE SECTOR! PROFESSIONALS

The writing on the wall is very clear. The corporate organization have to function in far more organized manner and strive for enhancing the long term value to the shareholders. Level of accountability to shareholders and the transparency of operations by disclosure through annual and other periodical reports are going to be much more than hitherto. The new norms of governance which are enshrined in the Bill compares well and they are better than international standards.

The work of the professionals in practice will also be subject to review by an independent quality review Board, as recommended by Naresh Chandra Committee. This may be implemented through the charter of the respective professional bodies.

CONCLUSION

Various steps have been taken at the global level to have a fool proof set up for the same, but non have proved to be flawless the recent Enron debacle has put us back to the basics. What is lacking? Can there not be any system which could secure public investment from being misused? Are the laws which are framed are not good enough to include all possibilities which may occur. Or is it the implementation stage where we are facing the problems.

CORPORATE GOVERNANCE WISDOM

In the context of this paper and the ongoing research the author has proposed the following points to be followed by the corporate regulatory authorities together with the corporates to ensure governance.

(a) **Values:** Moral values have a positive dynamism all of their own. These are not just “do’s and don’ts” set of rules. If one has to live up to an ideal, then he must be prepared to face ordeals, difficulties and tribulations. Many have lived to rise up to the mark because they have upheld these ideals and values in spite of vicissitudes and ordeals. Aeons may come and pass out, but the cardinal principles of ideals and values remain a perennial source of inspiration in attaining excellence in governance.

(b) **Power:** By and large, it is found that persons lacking competence and worthiness are occupying positions of power. This is the reason for the nation finding itself in the doldrums. Legitimately, therefore, men and women of character, good conduct and possessing ethical values, who are free from negative motives should be chosen to occupy and run the seats of power.

(C) **Strength:** Any organization’s progress is based on the strength and well-being of the people, which are its constituents. The need of the day is: people at the helm of the affairs of corporate governance and their team ought to work in the spirit of service, with vital enthusiasm, constructive imagination, pure self- motivation and alertness.

(d) **Dedication:** If one forgets the real significance of dedicated action for achieving excellence, all sorts of tnaals and tnbulations would arise. It can be seen that in managerial field of any discipline, people have gwen up their true nature and are keen only to earn quick buck at the cost of name and fame. Quick buck is slippery like soap and is bound to vanish in no time at all.

(e) **Refinement:** Diligent self-effort is needed on the part of everyone to elevate life from trivial to the sublime. No one attains acumen or good governance virtues at the moment of birth — it is only through various endeavours of training, learning, exposure and gradual but sure refinement that one can become mature. When one diligently and cheerfully accomplishes his duties and responsibilities, and stands accountable for the same, he will find that he will never covet any unproductive or self-dissipating ideas. To him, regrets of the past become meaningless and anxieties of the future are uncalled for, Constantly, therefore, he lives and works in the present with all the excitement.

(f) **Self-Management:** In most of the curriculums for management studies, different skills are taught. The most important of all these is the study of ‘self-management’. conduct and behaviour of an individual can be traced to one’s induction into specific skill and its application in practice.

(g) **Non-covetousness:** The following verse (author unknown) is full of deeper meaning:

*“Even a millionaire has to be content with food; He cannot live on a diet of gold!
When time is not favourable, gold may turn into dust;
And when it is favourable, even dust may turn into gold! The wheel of time can turn a scholar into a fool;
And a fool into a saint!
A wealthy man may become a plaything of adversity at some time;
Whatever your efforts may be, you cannot get what you do not deserve!
Oh Man, do not be covetous;”*

Instead, lead a noble life of virtue and good conduct, making proper use of your wisdom!’

(h) **Rules:** Conformity with rules and regulations without morality will not enhance one’s worth. Will any one in the field of corporate governance even think of showing respect to another if the other one displays negative traits overstepping all tolerable limits?

(i) **Organization:** An organization is always a conglomeration of various types of people doing various types of things for a common cause. An ideal organization, therefore, should have a scale of values and a code of morality which should be applicable to all individuals within the organization.

(j) **Fortune:** One’s good or bad fortune is directly related to his thoughts, words and deeds. Sowing the seed of good thought one reaps the fruit called good deed; sowing the seed of good deed he reaps good practice; from good practice, he reaps good fortune. This fortune is based on character, which is based on practice arising out of good deeds based on good thoughts.

(k) **Sagacity:** One always desires a pleasant time, good position, work-satisfaction, rewarding assignments, happiness at home and at workplace. All these and much more will be delivered unasked if one attains good character, virtue, sagacity and wisdom for self-conduct.

(l) **Self-Conduct:** The future of an individual will depend on his conduct. The organization will be a safe, secure, peaceful and prosperous work-place only when the individuals working for it have good character and conduct.

(m) **Synergy:** To be ever useful to the organization, keeping oneself physically energetic, mentally alert, and intellectually wise, three aspects are necessary: namely, develop healthy physique, purity of mind, intellectual perseverance and wisdom of patience.

(n) **Simplicity:** It is said, simplicity is the hallmark of greatness. He is considered to be great if he executes his daily tasks and responsibilities in a spirit of mutual co-operation, tolerant of the errors and failings of others, looking upon them with sympathy, with one’s own sentiments tender and ever helpful, guiding them to excel in their endeavours, without any bias, envy or vindictiveness.

(o) **Comfort:** Riches should be compared to the shoes one wears! If accumulation of wealth and money is rather large, then like shoes these are a hindrance in walking — too much accumulation may breed egotism, sloth and contempt for others. Likewise, too less of earning of wealth hurts. Therefore, to be rich is not necessarily to be happy.

(p) **Nobility:** When in a person enthusiasm, determination, courage, wisdom, endeavour, innovativeness, humility and grace are evident, know that person to be noble. On the other hand, obstinacy is rude and rough, mischief is crude and tough, jealousy breeds unhappiness, anger will bring about decline, worries will invite diseases.

(q) **Behavior:** Governance becomes a glorious experience only when it is blended with positive motives, universally beneficial attitudes and humane qualities.

(r) **Profit & Loss:** One is elated and joyful if the venture yields profits, but one is dejected and miserable when met with losses. These feelings are natural. Under the circumstances, it is wise to be vigilant and enjoy or suffer the inevitable consequences, smilingly. In the face of difficulties, never to lose heart and precipitate unwarranted action but pause and ponder as to how they ever came to be and how to overcome them with integrity.

(s) **Honesty:** With regard to honesty, it is often misconceived and misbelieved that to be honest in governance and business dealings will sustain loss — this is not true. Initially, perhaps, it may present some unforeseen difficulties and hurdles, but in I course of time, integrity and honesty are bound to bring their own reward. Transparency in accounting and audit practices certainly raises the image of an organization.

I cannot think of a concluding note except reproducing a portion of the End Note' from the Report of the Narayana Murthy Committee which reads: -

“Effectiveness of a system of corporate governance cannot be legislated by law nor can any system of corporate governance be static. In a dynamic environment, systems of corporate governance need to be continually evolved. The Committee believes that its recommendations raise the standards of corporate governance in Indian firms and make them attractive for domestic and global capital. These recommendations will also form the base for further evolution of the structure of corporate governance in consonance with the rapidly changing economic and industrial environment of the country in the new millennium.”

REFERENCES