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Part I Corporate Governance and Corporate Law Reform in India: III. Related Information on Corporate Governance

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retrograde, as the industry feels that a board position should be based on expertise, knowledge and qualification and not on gender.

Though the withdrawal of Bill by the government would affect the confidence of shareholders, it is felt that the basic objective of any amendment to legislation is to act as a facilitator and not a hindrance. Before any amendment in Companies Act, 1956 is put on the statute book, it should be ensured that the intended reforms provide a conductive environment for healthy corporate growth and development.

The impact of every legislative initiative on different sections is varied; good governance demands that the choice of a course of action is dictated by principles of greater common good. So, the government has considered the redrafting of the Bill so as to alleviate the concerns of the industry. This will also assist in grooming a perfect legislation through a collaborative approach of all concerned.

III Related Information on Corporate Governance

1. Enforcement of Accounting Standards

During 2003, new international accounting standards, guidance notes, auditing and assurance standards came into play. This has brought Indian Corporate accounting closer to International Accounting Standards (IAS). As on November 2003, there were 30 subjects covered by both Indian accounting and the IAS. The subjects include like earning per share, segment reporting, leases, consolidated financial statements and impairment of assets which are dealt both in India as well as under IAS.

Chartered Accountants Act, 1949:

The Government has moved a bill on 22 December 2003 in Rajya Sabha called *the Chartered Accountants (Amendment) Bill, 2003* to enlarge the definition of 'professional misconduct'. The bill, when passed, will equip the Department of Company Affairs (DCA) with powers to specify acts and omissions that amount to professional misconduct, in order to keep both the professionals and professional bodies under control. The bill lists 23 acts and omissions that could amount to misconduct for CAs, as against 13 already listed in the Act.

The Institute of Chartered Accountants of India (ICAI) follows a council-level and disciplinary committee-level regulatory mechanism. At council level, it scrutinizes complaints received against members, and forms *prima-facie* opinion on whether to refer the case to the disciplinary committee. Next, the disciplinary committee conducts its enquiry and concludes whether the member is guilty or not. The first schedule of the Act centres on the conduct of CAs and checks their professional independence and integrity. For instance soliciting clients for professional work, charging fee as a percentage on profits are deemed as misconduct. The second schedule, which requires action by a high court, deals with failure to disclose substantial interest by the CA in his report while expressing his opinion on financial statements, in which he or his firm or partner of his firm has strategic interest.[35]

In future, auditor's appointment shall be subject to the terms and conditions 'as may be prescribed', and auditor shall give a written certificate to this effect. To assure auditor independence and arm's length distance between auditor and auditee company, certain disqualifications have been proposed under the Bill. The fine for the auditor, who is in default, has been increased to three times of total remuneration or Rs. fifty thousands or whichever is more.

2. Bankruptcy Law Reforms:

Bankruptcy rules are an important aspect of corporate governance. These rules help in determining that how a company is to be controlled and managed and whose claims have priority when it faces financial difficulties and especially if it seeks the protection of the bankruptcy courts. On bankruptcy, the Indian law closely follows the principles of English common law.

India is unique in having a very large number of sick companies. In most other countries it is illegal to trade when bankrupt, or when insolvency can be clearly seen, but in India bankrupt companies do not disappear. The Industrial Disputes Act, 1947 makes it illegal to close down an industry without the state government permission. The Sick Industrial Companies Act (SICA) was passed to solve the sick companies problem. Under the Act, the Board for Industrial and Financial Reconstruction (BIFR) was set-up. The Parliament has now passed an Act to set-up a National Company Law Tribunal (NCLT). Every

company whose net worth has been eroded by up to 50% will have to be mandatorily referred to NCLT and about 1,569 cases pending with BIFR shall be referred to NCLT.

Under the present law, existing management generally remains in control as a 'debtor in possession' and is given at least 120 days to file a reorganization plan. The exception is if the court finds fraud, dishonesty, mismanagement, or incompetence. Sections 425 to 560 of the Indian Companies Act, 1956 provide the mechanism of company's winding up. Matters which relate to winding up by court will now be handled by Benches of NCLT.

Cross-border Insolvency and Indian Law

Cross border insolvency occurs when the business activity of a corporation extends to two or more countries and it may become difficult for the winding up to be performed in a single jurisdiction. However, Indian law has not taken into consideration any cross border relations. Indian insolvency laws do not have an extra-territorial jurisdiction, nor do they acknowledge the jurisdiction of foreign courts regarding the branches of foreign companies operating in India. Thus, if a foreign company is taken into liquidation outside India, its Indian business will not be automatically affected unless an application is filed before an insolvency court for the winding up of its branches in India. According to the Income Tax Act, 1961, a company registered outside India but having its management and control in India, is considered an Indian company for the purpose of corporate taxation. Under the Companies Act, 1956, the Indian courts have the jurisdiction to entertain winding up proceedings in respect of the following two categories of companies:

- When a company has been incorporated in India – irrespective of the fact that the entire business of the company is carried on outside India, or that all its members are foreigners.
- When it is an unregistered company – Foreign companies in India fall in this category if their winding up proceeding is not falling under section 584. Section 588 lays down the circumstances in which a foreign company may be wound up.

Thus, the Courts/NCLT have a statutory jurisdiction to wind up a foreign insolvent company as an unregistered company.

3. Corporate Social Responsibility

These are the years of e-commerce, cost cutting, redundancies, mergers and acquisitions, hostile-takeovers, development in communication technology. In this scenario, the role of the government has to be to provide environments in which companies can compete internationally. Regional blocks – that produce greater cohesion and closer economic integration than the traditional nation state – will replace the power of individual government. Power games are the fabric of the current Global Economic Structure which encourages competition. The competition has merits: it enables the best to win; it encourages improved performance and standards; it is an effective way of choosing between alternatives; it encourages people to prove their mettle. However, there can be human price to pay.

The recent debate on corporate governance has mainly centered on practical issues, such as concern about corporate fraud, the abuse of managerial power corporate and social responsibility. However, the effective corporate governance is a combination of ethical, physical, financial, mental, emotional and spiritual intelligences. These qualities enable decisions to be more result-oriented. Corporate governance is nothing, if not human.

The concept that corporate governance is only about enhancing stakeholders financial wealth and making only shareholders happy is not correct. It is possible both to generate wealth and at the same time benefit people in terms of non-financial aspects of their lives. Corporate management, by its actions and power not only affect the company, but also affect labour especially when the corporations are shut down. Corporate managements, however, are often focused only on their profit making goals and they tend to forget about the human implications of decisions they take or their impact on communities. Corporate governance is thus as much for human beings as for its business objectives. Hence, there is a need for expertise, knowledge and skill, which are essential for efficient governance.

Corporate governance should not be reduced to mere compliance with rules, regulations and codes of practices on paper. It is a process whereby people in power direct, monitor and lead corporations. Their decisions affect physical environment, the goods and services, ways of communication, the working and family lives. So, the corporate governance is not only about the business of making money for shareholders, but it is also about the quality of life we can live as human beings.[36]

The prerequisite of a corporate democracy is that decision-making few shall be accountable to the many affected by their decisions. The decision-making needs to be institutionalized. However, the laws governing the creation and administration of limited liability companies do not provide for the directors to even heed, not to say accountable, to the workers employed, the consumers of their goods and services or the community in which they operate. A company's sole responsibility, so far as the company law is concerned, is only to shareholders and creditors. It is the task of the government to see that corporation to which it grants the right of incorporation also fulfills its social responsibility. Public interest in the context of company law means maintenance of the health of the corporate sector and creation of conditions suitable to its healthy growth. It also means the protection of interests of the members, investors, creditors, and workers of the company, and not merely the group of shareholders that may be controlling company's finance or management.

There is an urgent need to monitor that competition and the human side should be simultaneously managed. There are numerous examples that people involved in corporate governance are making a difference to human side. Bharat Petroleum's policies on pollution, for example, had a major effect on the oil industry. Nagarjuna Fertilisers has created a beautiful natural environment and has also helped to improve the lives of the local farmers and small industries. Tatas have been very active in the area of town planning, education, community health, water management etc. The Birla group has been associated with a number of activities including building temples as also building and running large multi-specialty hospitals. Among the newer groups, Infosys Technologies has set up an Infosys Foundation, with the specific purpose of undertaking community projects in the areas of education, rural development, promotion of art and music. WIPRO has also been a forward-looking company actively working with school children, especially from the under-privileged sections of the society. However, there is a need to move from just "charity" approach, and social responsibility initiatives have to be integrated with the business strategy.

Conclusion

The genesis of corporate governance lies in business scams and corporate failures. The concept of corporate governance hinges on total transparency, integrity and accountability of the management. Corporate governance is a process to ensure that

company is managed to suit the best interests of all stakeholders, yet the maximization of shareholder's wealth is the corner stone of good corporate governance. It is about, how a company fulfils its obligations to investors and other stakeholders. It is about commitment to values and ethical business conduct. The best practices of corporate governance should include – a definition of practices that define good governance; a code of best practices covering the constitution of the board, it's various committees, defining their goals and responsibilities, exploring preferential internal systems and disclosure requirements.

Studies of corporate governance practices across several countries conducted by the Asian Development Bank (2000), International Monetary Fund (1999), Organization for Economic Cooperation and Development ("OECD") (1999) and the World Bank (1999) reveal that there is no single model of good corporate governance. This is recognized by the OECD Code. The OECD Code also recognizes that different legal systems, institutional frameworks and traditions across countries have led to the development of a range of different approaches to corporate governance. Common to all good corporate governance regimes, however, is a high degree of priority placed on the interests of shareholders, who place their trust in corporations to use their investment funds wisely and effectively. In addition, best-managed corporations also recognize that business ethics and corporate awareness of the environmental and societal interest of the communities within which they operate, can have an impact on the reputation and long-term performance of corporations.

In 1999, the World Bank and Organization for Economic Cooperation and Development (OECD) joined together to create a forum of governance assistance - the Global Corporate Governance Forum. The two agencies jointly asserted that governance reform is an important element in strengthening the foundation for individual countries' long term economic performance and contributing to a strengthened international financial system. Better governance is fundamentally a process in which the government and the private sector join hands. The Forum attracted support from a Private Sector Advisory Group (PSAG), and powerful Investor Responsibility Task Force that planned to improve governance standards in emerging markets. The Forum's first practical project is to co-operate with the Confederation of Indian Industry (CII) to bring 50 Indian companies into compliance with New York Stock Exchange Standards of disclosure and accountability.

There are, however, several corporate governance structures available in the developed world but there is no one structure, which can be singled out as being better than the others. There is no "one size fits all" structure for corporate governance. Each country has its own corporate culture, national personality and priorities. Similarly, each company has its own history, culture, goals and business cycle maturity. All these factors must be taken into consideration in crafting corporate governance structure and practices for any country or any company. However, the influence of international capital markets definitely has some convergence on governance practices. Corporate governance extends beyond corporate law. Its fundamental objective is not mere fulfillment of the requirements of law but in ensuring commitment of the board in managing the company in a transparent manner for maximizing long-term shareholder value.

India, even before the Asian financial crisis of 1998, took steps for corporate governance. The CII evolved a code of best practice in 1998, which was a self-regulatory effort by business leaders, followed by the second code of SEBI in 1999, that was tougher than CII code and aimed to make compliance part of listing agreement. Simultaneously amendments were introduced in the company law in 2002 and a bill was introduced in 2003 based on the recommendations of various high power committees. It is hoped that enforcement of these measures in letter and spirit will help boost Indian and foreign investors confidence in Indian corporate sector.