EMERGENCE AND DEVELOPMENT OF CORPORATE GOVERNANCE IN UK, USA AND INDIA

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I. Introduction

Till 19th century, under the traditional enterprise model - the business landscape was mostly filled with unincorporated business associations where individual owners were themselves the controllers of the business.[2] But at the turn-around of the 19th century, registered public companies emerged with their capability to facilitate large-scale investment with minimum risk to the investors.[3]

This transformation necessitated the requirement of a special cadre of corporate managers – separate and distinct from the shareholders in such large companies, to develop and implement corporate strategy on their responsibility.[4] The reasons for separate ownership and management were:

- In large companies with huge number of shareholders, taking management decisions through the shareholders meeting would have been extremely cumbersome.
- Since the company's capital needs led to a public offering of shares, there is no guarantee that the shareholder have the necessary expertise to run large companies.[5]

This separation became the central issue of the corporate governance debate, because since the historic development has been one of a movement from a situation in which shareholders were both investors and managers, to one where the management became a separate function from that of investment - naturally the accountability of these corporate managers towards such shareholders became a matter of concern.[6] Hence good corporate governance focuses on creating lines of accountability on such

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[2] Dignam, Alan. & Lowry, John., *"Company Law"*, 5th ed., (2009), Oxford University Press: New York, Pp 356-396 Pp 356-396 at *p.357*

[3] *Ibid*

[4] Davies, Paul L., *"Gower And Davies' Principles of Modern Company Law"*, 7th ed., (2003), Sweet & Maxwell: London, Pp. 291-293 at *p.291*

[5] *Ibid*

[6] *Ibid*

separate management towards various other groups of stakeholders who have long term interest in the company.[7]

II. Meaning and Need of Corporate Governance

Meaning: Although Corporate Governance is being discussed highly specifically over the last two decades, yet the subject is as old as company law.[8] Actually, what was earlier referred as 'Social Responsibilities of Business', has now been labeled as 'Corporate Governance'.[9]

The most extensively used definition being that -"it is the system by which companies are directed and controlled. It is the framework by which the various stakeholder interests are balanced or, the relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders".[10] The OECD states: "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders and provides the structure for setting objectives, determining means of attaining them and monitoring performance of the company." [11]

Hence good corporate governance ensures that the management meets its obligations towards all its stakeholders, namely the owners (i.e. the shareholders), creditors, employees, consumers, Government and society at large.[12]

Need: The need for corporate governance arises because of:

- ✓ Separation of management from ownership;
- ✓ Anonymity between the producer and the ultimate consumers; and
- ✓ Realization that business, being part of the society, has certain social responsibilities.[13]

The Management of any corporation should begin with the fundamental reality that their company must produce two products viz:

- o the economic goods and services of the firm; and

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7 *Supra* note 3 at *p.292*

8 *Supra* note 3 at *p.291*

9 Majumdar, A.K., and Kapoor, Pr. G.K., *"Taxmann's Company Law"*, 12th ed., (2009), Taxmann Publications (P.) Ltd.: New Delhi, Pp. 586-591 at *p.586*

10 Cadbury Committee, 1992 of UK

11 Organization for Economic Co-operation and Development (OECD) Principles of Corporate Governance of 1999

12 *Supra* note 8

13 *Ibid*

- the social effects on the people involved in the production, distribution and consumption of those goods and services, both inside the company and in the community in which it operates.[14]

A management owes responsibilities towards all stakeholders of the company in order to ensure that the business sub serves various groups effectively and efficiently.[15]

III. Developments in UK and USA

Development in UK: The sudden concern for the good corporate governance was the result of the appointment of the Cadbury Committee to reform the UK listed companies due to successive impacts of scandal and recession in the 1980s and early 1990s in UK.[16]

The Cadbury Committee (1992) on the Financial Aspects of Corporate Governance: The growing concern at the general public distrust on large companies and the lack of confidence in reports, accounts and audit statements following the collapse of some of the prominent listed companies in UK[17] prompted the creation of the **Cadbury Committee** by the London Stock Exchange, The Financial reporting Council and the combined accounting bodies of UK.[18]

Under the chairmanship of ***Sir Adrian Cadbury***, the recommendations of the committee, which got published as the ***Code of Best Practice*** in **1992**, were as follows:

- ✓ It emphasized the key role of the Board of Directors in the company's decision making process, especially in deciding the major transactions. [19]
- ✓ The key roles of Managing Director or the Chief Executive Officer and Chairman of the Board should never be combined to prevent concentration of power and individual domination in the board.[20]
- ✓ The board should have NEDs in sufficient number, who shall be independent of the company and play significant role in board decisions.[21]

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14 *Ibid*
15 *Ibid*
16 *Supra* note 1 at *p.381*
17 BCCI, Polly Pack and the Robert Maxwell Group
18 *Supra* note 8 at *p.587*
19 *Supra* note 1 at *p.382*
20 *Ibid*
21 *Ibid*

- ✓ A committee structure to be set up, whereby sub-committees consisting of NEDs to be created, to improve the accountability of the appointment of directors, their remuneration and audit process.[22]

Although these recommendations were not enforceable Listing Rules, yet majority of them were implemented by the London Stock Exchange. [23]

The Greenbury Committee (1995) report on Directors' Remuneration, Report of the Study Group: The **Greenbury Committee** headed by ***Sir Richard Greenbury,*** recommended**-** there should no executive in the remuneration committee which shall take note of wider economic scene both inside and outside the company while taking executive salary decisions; and there should be higher levels of salary disclosure in the annual accounts of companies which would facilitate closer scrutiny of the directors' remuneration.[24]

The Hampel Committee (1998) on the Combined Code on Corporate Governance: The **Hampel Committee**, under the chairmanship of ***Sir Ronald Hampel*** reviewed the earlier reports of *Cadbury* and *Greenbury*, and after coming up with a **Final report** in ***January 1998***, further consolidated their implementations in one super code in ***June 1998*** - called the **Combined Code.** [25]

The recommendations of the Hampel Committee were:

- ✓ The NEDs should have a leader, which in effect will create 3 power bases on the board along-with the Managing Director and the Chairman of the company. [26]
- ✓ Institutional investors or shareholders should enter into a dialogue with the companies where required and also consider voting at the Annual General Meetings.[27]
- ✓ The board should maintain a balance of executive and non-executive directors (minimum 1/3rd of NEDs) to prevent individual domination in board decisions.[28]
- ✓ The procedure for deciding executive directorial remuneration including hidden costs to the company should be transparent and the

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[22] *Ibid*
[23] *Ibid*
[24] *Ibid*
[25] *Supra* note 1 at *p.385*
[26] *Supra* note 1 at *p.385*
[27] *Ibid*
[28] Morse, Geoffrey., *"Charlesworth & Mourse Company Law"*, 16th ed., (1999), Sweet & Maxwell: London, Pp. 343-348 at *p.345*

company's annual report should contain a statement on its remuneration policy.[29]

The Turnbull Committee (1999) on the Internal Control: Guidance for Directors on the Combined Code, headed by ***Nigel Turnbull***, recommended that Directors should have the primary responsibility for a system of 'internal controls' of the company to evaluate and deal with both financial and non-financial risks.[30] The UK government introduced ***Directors' Remuneration Reporting Regulations 2002*** which requires directors' salaries to be put to the shareholders for an advisory vote.[31]

Higgs Report (2003) on Independent Review of the Role and Effectiveness of Non-Executive Directors: After the collapse of Enron, the DTI[32] announced a review of the effectiveness of UK NEDs and appointed ***Derek Higgs*** in ***April 2002***, who produced a final report published in ***January 2003***.[33]

Apart from providing the definition of 'independence'[34], its key recommendations were as follows:

- ✓ NEDs should constitute minimum half of company's board (excluding Chairman) and they should meet annually without the Chairman or any executives.[35]
- ✓ The position of the CEO or Managing Director should never be combined.[36]

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[29] *Supra* note 27 at *p.346*

[30] *Supra* note 1 at *p.385*

[31] *Ibid*

[32] Department of Trade and Industry or DTI, which changed its name in June 2007, to Department for Business, Enterprise and Regulation Reform or DBERR

[33] *Supra* note 1 at *p.394*

[34] The Higgs Review set out the following definition of *'independence'*:
A NED is considered independent when the board determines that the director is independent in character and judgment and there are no relationships or circumstances which could affect, appear to affect, the director's judgment. Such relationships and circumstance arise where the director: is or has been an employee of the company; has or had a business relationship with the company; is being paid by the company other than a director's fee and certain other payments; has family ties to the company or its employees; holds cross-directorships or has significant links with other directors through involvement in other companies or bodies; represents a significant shareholder; has served on the board for 10 years.

[35] *Supra* note 1 at *p.394*

[36] *Ibid*

- ✓ The NEDs should play important role in the company's strategy, performance; risk management; and executive directors' remuneration.[37]
- ✓ A senior independent director should be identified who fulfills the requisite criterion and who shall be the point of contract for the shareholders.[38]

Smith Report (2003) Guidance on Audit Committees: The **Smith Report** in ***2003*** which recommended an auditor of a company himself should look at whether the company's corporate governance structure provides safeguards to preserve his own independence.[39]

Both the recommendations from the Higgs and Smith Reports led to modifications in the ***Combined Code of Corporate Governance*** published in ***July 2003*** and applied to all companies listed on or after 1 November 2003.[40]

The UK Corporate Governance Code 2010: Being influenced by the European Commission's *"Corporate Governance and Company Law Action Plan" (May 2003),* the UK government finally came up with **the UK Corporate Governance Code** (hereinafter referred as **Code**), being applicable to financial years beginning on or after **29 June 2010**. The various provisions of the Code are summed up below:

- ✓ The board shall be collectively responsible for the long-term success of the company, and there should be a comprehensible division of responsibilities between the running of the board and the executive responsibility for the running of the company's business.[41]
- ✓ The chairman should be responsible for leadership of the board and guarantying its effectiveness.[42]
- ✓ The NEDs should be members of the board shall have the power to constructively challenge the board decisions.[43]
- ✓ The board and its committees should constantly update their skills and knowledge.[44]

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37 *Ibid*
38 *Supra* note 1 at *p.395*
39 *Ibid*
40 *Ibid*
41 UK Corporate Governance Code 2012: *Section A* provides for *Leadership*
42 *Ibid*
43 *Ibid*
44 UK Corporate Governance Code 2012: *Section B* provides for *Effectiveness*

- ✓ The procedure for the appointment of new directors to the board should be absolutely formal, strict and transparent.[45]
- ✓ The board must be supplied with all information timely to discharge its duties effectively.[46]
- ✓ The board should make an annual evaluation of its own performance, its committees and individual directors.[47]
- ✓ The board should present a balanced and understandable assessment of the company's position and prospects and should maintain sound risk management and internal control systems.[48]
- ✓ The board shall remain transparent while applying the corporate reporting for maintaining an appropriate relationship with the company's auditor.[49]
- ✓ Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose.[50]
- ✓ The procedure for developing executive remuneration policy and fixing individual directors remuneration packages should be transparent.[51]
- ✓ The board should conduct satisfactory dialogue with shareholders on the mutual understanding of objectives and shall use the AGM to communicate with investors.[52]

Development in USA: After the collapses of Enron, WorldCom, Tyco, etc, the **US Sarbanes-Oxley Act** was passed in United States on **30thJuly, 2002**, which applies to all US companies and non-US companies that required filing periodic reports with the US Securities and Exchange Commission (SEC).[53] The Act introduced much more extensive reporting requirements

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45 *Ibid*
46 *Ibid*
47 *Ibid*
48 UK Corporate Governance Code 2012: *Section C* provides for *Accountability*
49 *Ibid*
50 UK Corporate Governance Code 2012: *Section D* provides for *Remuneration*
51 *Ibid*
52 UK Corporate Governance Code 2012: *Section E* provides for *Relation with Shareholders,* besides *Schedule A* provides for the *Design of performance related remuneration* and *Schedule B* provides for the *Disclosure of corporate governance arrangements*
53 *Supra* note 1 at *p.392*

for UK companies listed on any US Stock Exchange or with registered debt securities in US.[54]

The US Sarbanes-Oxley Act, 2002 (SOX): Mandating strict reforms to improve financial disclosures from corporations and prevent accounting fraud, some of the important provisions of which are discussed below:

- ✓ SOX increases corporate responsibility; increases penalties for corporate wrongdoing; protects the objectivity and independence of securities analysts; and increases Securities and Exchange Commission resources etc.[55]
- ✓ SOX creates a new board (PCAOB) consisting of five members of whom two will be certified public accountants. All accounting firms have to get registered with the board. The board will make regular inspection of firms and report to SEC which will be ultimately forwarded to Congress.[56]
- ✓ Provides for mandatory rotation of lead audit or coordinating partner and the partner reviewing audit once every 5 years.[57]
- ✓ In each annual and quarterly report, the CEO and CFO should certify that the financial information in the report fairly reflects the exact financial condition, results of operations and cash flows of the company.[58]
- ✓ The CEO and CFO being responsible for maintaining disclosure controls and procedures, must evaluate their effectiveness of the disclosure controls and procedures within the last 90 days revealing all 'significant deficiencies' and 'material weaknesses' in internal controls to the auditors and the audit committee, including any fraud involved in management.[59]
- ✓ The CEO and CFO must indicate in the report about any significant changes in internal controls including corrective actions.[60]
- ✓ Any officer or director of an issuer, or any other person acting under the direction thereof, should not act fraudulently to influence,

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[54] *Ibid*

[55] Zameeruddin, Rizvana., *"THE SARBANES-OXLEY ACT OF 2002: AN OVERVIEW, ANALYSIS, AND CAVEATS"*, Available at: http://www.westga.edu/~bquest/2003/auditlaw.htm

[56] Section 101 of SOX, 2002 provides for *Public Company Accounting Oversight Board*

[57] Section 203 of SOX, 2002 provides for *Audit Partner Rotation*

[58] Section 302 of SOX, 2002 provides for *Disclosure Controls*

[59] *Ibid*

[60] *Ibid*

coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of that issuer for the purpose of rendering such financial statements materially misleading.[61]

- ✓ Disclosure of all material off-balance sheet items should be compulsory and an SEC is required to study and report to better understand the extent of usage of such instruments and whether accounting principles adequately addressed these instruments.[62]
- ✓ No issuer should extend credit directly or indirectly, including through a subsidiary to any director or executive officer, including extending, modifying, or renewing any personal loan to a director or officer -violation of which can subject a company to criminal penalties.[63]
- ✓ Management and the external auditor ought to report on the adequacy of the company's internal control on financial reporting and the management must produce an 'internal control report' as part of each annual Exchange Act report, containing an assessment, as of the end of the most recent fiscal year of the Company, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.[64]
- ✓ An additional statement disclosure is required as to whether the audit committee includes one person who is a 'financial expert'[65].[66]
- ✓ Every periodic report containing financial statements filed by the companies must accompany a written statement by the company's CEO and CFO certifying that it fully complies with the requirements

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[61] Section 303 of SOX, 2002 provides for *Improper Influence on Conduct of Audits*

[62] Section 401 of SOX, 2002 provides for *Disclosures In Periodic Reports (Off-balance sheet items)*

[63] Section 402 of SOX, 2002 provides for *Prohibition on Personal Loans to Executives*

[64] Section 404 of SOX, 2002 provides for *Assessment Of Internal Control*

[65] Under Section 404(c) : A *'financial expert'* is an individual who - through education and experience as a public accountant, auditor, CEO, comptroller or principal accounting officer of an issuer or from a similar position involving the performance of similar functions has – (1) an understanding of generally accepted accounting principles and financial statements; (2) experience in – (A) the preparation or auditing of financial statements of generally comparable issuers; and (B) the application of such principles in connection with the accounting for estimates, accruals, and reserves; (3) experience with internal accounting controls; and (4) an understanding of audit committee functions.

[66] Section 407 of SOX, 2002 provides for *Disclosure Of Audit Committee Financial Expert*

of Sections 13(a) or 15(d) of the Securities Exchange Act, 1934 and that it does not include any untrue statement or omissions of material facts failure of which attracts criminal penalty.[67]

- ✓ The Act also provides criteria for NEDs on the audit committees of the companies.[68]

The *Financial Executives International (FEI) 2007* study and research by the *Institute of Internal Auditors (IIA)* indicate SOX has improved investor confidence in financial reporting. In fact, the UK Corporate Governance Code, 2010 has been enacted in the line of SOX.[69]

IV. Corporate Governance in India

Development: Although the Companies Act 1956 itself provided for certain disclosures by way of maintaining certain registers, filing of reports, reporting in directors' report, disclosure of interest by directors, statutory audit and the duties of the auditors in reporting on certain matters, yet the major corporate governance initiatives were launched in India since the mid-1990s.[70]

Constitution of Securities and Exchange Board of India (SEBI) 1992: In 1992, the Indian Parliament created the SEBI to "protect the interests of investors in securities and to promote the development of, and to regulate, the securities market."[71] SEBI issued many guidelines since 1992 in the interest of investors' protection[72].[73]

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[67] Section 906 of SOX, 2002 provides for *Criminal Penalties For CEO/CFO Financial Statement Certification*

[68] *Supra* note 1 at *p.393*

[69] *"An Introduction to Corporate Governance"*, Pp.1-30, at *p.13* Available at: http://shodhganga.inflibnet.ac.in/bitstream/10603/1558/10/10_chapter1.pdf

[70] *Supra* note 8 at *p.588*

[71] Khan, Sabaha., *"Understanding the Concept of Corporate Governance in the light of Companies Bill 2009: An Analysis of Proposed Amendments"*, (2010), Available at: http://legalservicesindia.com/article/article/understanding-the-concept-of-corporate-governance-in-the-light-of-companies-bill-2009-463-1.html

[72] These guidelines contain requirements with respect to initial public offers, declaration of quarterly results, timely disclosure of material and price sensitive information, the guidelines for preferential allotment at market related prices, providing for a fair and transparent framework for take-overs and substantial acquisitions, dispatch of one copy of complete balance sheet to every household and an abridged balance sheet to all shareholders.

[73] *Supra* note 8 at *p.588*

Confederation of Indian Industry (CII) - Desirable Corporate Governance: A Code (March 1998): The CII committee under *Shri Rahul Bajaj,* after examining corporate governance issues, suggested a voluntary code in April 1998 recommending *'Desirable Disclosure'* by listed companies on high and low monthly averages of share prices in a major stock exchange where the company is listed; greater detail on business segments, review of operations, analysis of markets and future prospects, etc along-with a corporate governance compliance certificate, signed by the CEO and the CFO.[74]

Kumar Mangalam Birla Committee Report (May 7, 1999) and Clause 49: Since the CII's Code's adoption was voluntary, few firms embraced it. Thus, SEBI appointed a Committee under *Kumar Mangalam Birla* to fashion a code of corporate governance.[75] In 2000, SEBI accepted the Committee's recommendations and introduced Clause 49 into the Listing Agreement of Stock Exchanges.[76] Clause 49 outlines requirements vis-à-vis corporate governance in exchange-traded companies.[77] The committee identified 3 key constituents of corporate governance as the share holders - the Board of Directors and the Management; and recognized major 3 aspects namely accountability, transparency and equality of treatment for all shareholders.[78] The committee looked at corporate governance from the stakeholders' point of view, so the control and reporting functions of boards and the role of its committees and management, all assume special significance when viewed from this perspective.[79]

Naresh Chandra Committee Report (2002): After the US SOX Act, 2002 was passed; a committee under *Naresh Chandra*[80] was constituted on August 21, 2002 which reported on December 23, 2002 focusing on auditors, CEO/CFO certification and on the role of independent directors. [81] Centering on financial and non-financial disclosures; and independent auditing and board oversight of management, the committee reported on various aspects concerning corporate governance such as role, remuneration, and training etc. of independent directors, audit committee, the auditors and then relationship and roles with the company.[82]

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74 *Supra* note 68 at *pp.14-15*
75 *Supra* note 70
76 SEBI on February 21, 2000 adopted the Birla Committee's recommendations as Guidelines for Good Corporate Governance.
77 *Supra* note 70
78 *Supra* note 68 at *p.15*
79 *Ibid*
80 A former cabinet secretary
81 *Supra* note 70
82 *Supra* note 68 at *p.21*

Narayana Murthy Committee report on Corporate Governance (2003): SEBI in 2003 set up a committee under *Mr. N. R. Narayana Murthy* to review Clause 49. The committee recommended audit committees, audit reports, independent directors, related party transactions, risk management, directorships and director compensation, codes of conduct and financial disclosures.[83]

Salient features of the amended Clause 49: Clause 49 has been further amended *vide* SEBI's Circulars dated October 29, 2004[84] and April 8, 2008[85].[86] Following are the important mandatory provisions under Clause 49:

V. Mandatory Provisions

1. *Composition of Board of Directors*

   I. Minimum fifty percent of the Board of directors should comprise of NEDs.[87]

   II. If the non-executive Chairman is a promoter or is related to promoters or persons occupying management positions at the board level or at one level below the board, at least 1/2 of the board should consist of independent directors. [88]

   III. Disclosures of relationships between directors *inter se* shall be made in specified documents/fillings.[89]

   IV. The gap between resignation/ removal of an independent director and appointment of another independent director in his place shall not exceed 180 days.[90]

   V. The minimum age for independent directors shall be 21 years.[91]

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[83] *Supra* note 68 at *p.23*

[84] This revision considerably diluted the original Murthy Committee recommendations. Areas where major changes were made include Independence of Directors; Whistle Blower policy; Performance evaluation of nonexecutive directors and Mandatory training of non-executive directors, etc.

[85] SEBI vide circular dated April 08, 2008 amended Clause 49 of the Equity Listing Agreement inter-alia including a provision stating that if the non-executive Chairman is a promoter or is related to promoters or persons occupying management positions at the board level or at one level below the board, at least one-half of the board of the company should consist of independent directors.

[86] *Supra* note 8 at *p.588*

[87] *Ibid*

[88] *Ibid*

[89] *Ibid*

[90] *Ibid*

VI. The company shall ensure that the person appointed as an independent director has the requisite qualifications and experience which would be use of the company.[92]

The old clause 49 limited definition of an "Independent Director" was widened in revised Clause to mean "a NED on the Board of a company who has integrity, expertise and the independence to balance the interest of various shareholders".[93] [94]

2. Audit Committee

I. Companies to set up a qualified and independent Audit Committee with an independent director as Chairman and the Company Secretary as its Secretary[95].[96]

II. Audit Committee shall have the power to investigate any activity within its terms of reference, to seek information from any employee, to obtain outside legal or other professional advice and to review powers with the Management and the external and internal auditors[97].[98]

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91 *Supra* note 8 at *p.589*

92 *Ibid*

93 *Ibid*

94 Who cannot be an independent director in a listed company-

- According to SEBI, having a 'pecuniary' relationship with the company or any of its arms, other than receiving the director's remuneration will be a disqualification.
- An independent director should not be related to the promoters or anyone in the senior management position from one level below the Board.
- He should not have been an executive of the company or of its audit, consulting or legal firms in the past three financial years.
- Beside, owning two percent or more of the block of voting shares or being a service provider to the company would disqualify one from taking up an independent director in a listed company.
- Nominee directors appointed by an institution which has invested in or lent to the company, shall, however, be deemed to be independent directors.

95 All members of the Audit Committee shall be NEDs, majority of them being independent, and with at least one director having financial and accounting knowledge.

96 *Supra* note 8 at *p.589*

97 The Audit committee shall review along-with the Management and the external and internal auditors of the company- the adequacy of internal control systems, internal audit function including the structure of internal audit department, staffing and seniority of official heading the department, reviewing the findings of the internal investigations by the internal auditors, discussion with external auditors, review company's financial and risk management policies and to look into the reasons for substantial defaults in the payment to depositors, debenture-holders, shareholders and creditors.

III. Meetings of the Audit Committee shall be held 4 times in a year with a gap not exceeding 4 months.[99]

IV. All pecuniary relationships or transactions of the NEDs with the company should be disclosed in the Annual Report.[100]

3. *Other Requirements*

I. As part of the director's report or as an addition thereto, a Management Discussion and Analysis Report should form part of the Annual Report to the shareholders.[101]

II. Remuneration of NEDs to be decided by the Board.[102]

III. Board to conduct meetings 4 times a year with a gap not exceeding 3 months.[103]

IV. Shareholders to be provided prescribed information about the appointment of new directors or for re-appointment of directors.[104]

V. Companies to provide in Annual Report a separate section on corporate governance.[105]

VI. Companies to obtain compliance certificate from an auditor and to attach it with Director's Report.[106]

VII. Management must disclose to the Board all important financial and commercial transactions.[107]

VIII. Information like quarterly results and presentations made by the company to analysts shall be put on the company's website or shall be sent in such a form as to enable the stock exchange on which the company's listed to put it on its own website.[108]

IX. To expedite the process of share transfers, the Board shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents.[109]

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98 *Supra* note 8 at *p.589*
99 *Ibid*
100 *Ibid*
101 *Supra* note 8 at *p.590*
102 *Ibid*
103 *Ibid*
104 *Ibid*
105 *Ibid*
106 *Ibid*
107 *Ibid*
108 *Ibid*
109 *Ibid*

Besides, the revised Clause 49 also provides for some ***Non-mandatory requirements.***[110]

Provisions of the Corporate Governance in the Companies Act, 1956 of India: The Companies (Amendment) Act, 2000 which focused essentially on good corporate governance, made the following amendments in the Companies Act, 1956.[111]

1) *Passing of Resolutions through Postal Ballot*: **Section 192A** was introduced to allow members/shareholders to vote through postal ballot[112].[113]

2) *Directors' Responsibility Statement*: Introduced **Section 217 (2AA)** requiring Directors' Report to include a responsibility statement with respect to certain matters[114].[115]

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[110] Non Mandatory provisions under Clause 49:
- Independent Directors may have a tenure not exceeding, in the aggregate, a period of nine years on the Board of the Company.
- The Board may set up a remuneration committee to determine the company's policy on remuneration packages for executive directors.
- A half-yearly declaration of financial performance including summary of the significant events in last six months, may be sent to each household of the shareholders.
- Mechanism for evaluating non-executive Board members by peer group should be in place. This peer group evaluation could be the mechanism to determine whether to extend/continue the term of appointment of non-executive director.
- Whistle Blower Policy should be made to be implemented. This is a mechanism for employees to report to the management concerns about unethical behavior, actual or suspected fraud or violation of the company's code of conduct or ethics policy.

[111] *Supra* note 8 at *p.590*

[112] Through rules made by the Central Government, postal ballot has been made mandatory for certain matters, Assent or Dissent to a resolution is required to be sent within 30 days. This facility is likely to result in true democracy in management of companies.

[113] *Supra* note 8 at *p.590*

[114] *Section 217 (2AA)* requires Directors' Report to include a responsibility statement with re4spect to the following matters :
- whether accounting standards had been followed in the preparation of annual accounts and reasons for material departures, if any;
- whether appropriate accounting policies have been applied and on consistent basis;
- whether directors had made judgments and estimates that are reasonable and prudent so as to give a true and fair vies of the state of affairs and profit and loss of the company;

3) *Audit Committees*: New **Section 292A** provides for constitution of audit committees by every public company having a paid-up capital of Rs. 5 crores or more. Audit Committee is to consist of minimum 3 directors and 2/3rd of its members shall be directors other than managing or whole-time director[116].[117]

4) *Secretarial Audit*: **Section 383A** was amended to provide for secretarial audit with respect to companies having a paid-up share capital between Rs.10 lakhs and Rs.2 crores. A whole-time CS must file with ROC certificate as to whether the company has complied with all the provisions of the Act[118].[119]

The Irani Report and Companies Bill 2009: The Ministry of Company Affairs established a committee under *Dr Jamshed J. Irani*[120], on December 2, 2004 to review the 1956 Act.[121] Its recommendations led to rewrite the new Companies Bill, initially laid before the Indian Parliament in 2008 and reintroduced in August 2009, as Companies Bill 2009[122]. [123]

- whether the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
- whether the directors had prepared the annual accounts on a going concern basis.

[115] *Supra* note 8 at *p.591*

[116] Recommendations of the Audit Committee on any matter relating to financial management including audit report shall be binding on the Board. Together with the requirements of Clause 49 with respect to audit committees, interest of various groups of investors and other stakeholders shall be better protected.

[117] *Supra* note 8 at *p.591*

[118] A copy of the ROC certificate shall also be attached with the Report of Board of Directors.

[119] *Supra* note 8 at *p.591*

[120] A director on the board of Tata

[121] *Supra* note 70

[122] The recommendations under Companies Bill, 2009 (which has now become Companies Bill 2011, with suggested amendments from the Ministry and yet to be passed), are as follows:
- Independent directors should constitute at least one-third of the board of a listed company. [Companies Bill 2009 Clause 132(3)]
- The definition of independence clearly excludes nominee directors. [Companies Bill 2009 Clause 132(5)]
- All listed companies are required to establish audit and remuneration committees. [Companies Bill 2009 Clause.158(1)]
- An independent director must be the chairman of the audit committee,[Companies Bill 2009 Clause.158(3)] - the majority of which is required to be independent, and only one director is required to have

Report of the CII Taskforce on Corporate Governance (November 2009): After the Satyam malfeasance, the CII set up a Task Force under *Mr. Naresh Chandra* in February 2009 to recommend ways to enunciate additional principles that can further improve corporate governance in spirit and in practice.[124] The report enumerates a set of voluntary recommendations[125]

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knowledge of financial management, audit or accounts. [Companies Bill 2009 Clause. 158(2)]

- The remuneration committee should be composed entirely of NEDs, only one of these need be independent. [Companies Bill 2009 Clause.158(10)]
- Certain key managerial personnel, namely the CEO, company secretary and CFO,- to be recognized by law along-with their liability in appropriate aspects of company operations. [Companies Bill 2009 Clauses.174-178 and also Clause. 2(1)(zza)]
- It empowers the Central government to establish a National Advisory Committee on Auditing and Accounting Standards, which would in due course and in consultation with the ICAI make recommendations to the Government, [Companies Bill 2009 Clause.118] to lay down accounting standards. [Companies Bill 2009 Clause. 119]
- Certain non-audit services are to be prohibited while others could be allowed provided there is pre-approval by the board or the audit committee. [Companies Bill 2009 Clause. 127]
- The internal controls should be certified by the CEO and CFO of the Company and in the Directors' report through a separate statement on the assessment. Companies Bill 2009 Clause. 120(4)(e) where it is provided that the Directors' Responsibility Statement shall state inter alia that "the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls have been complied with".
- The auditor's report shall state in the case of listed companies, whether the company has complied with the internal financial controls and directions issued by the Board. [Companies Bill 2009 Clause. 126(3)(i)]
- The audit committee can call for comments from auditors about internal control systems. [Companies Bill 2009 Clause.158(6)]

[123] *Supra* note 70

[124] *Supra* note 68 at *pp.25-26*

[125] The recommendations in brief are as under : Appointment of Independent Director; Duties, liabilities and remuneration of independent directors; Structure of Compensation to NEDs; Remuneration Committee of Board; Audit Committee of Board; Separation of the offices of the Chairman and the Chief Executive Officer; Attending Board and Committee Meetings through Tele-conferencing and video conferencing; Executive Sessions of Independent Director; Role of board in shareholders and related party transactions; Auditor – Company Relationship; Independence to Auditors; Certificate of Independence; Auditor Liability; Appointment of Auditors; Qualifications of Auditors Report; Whistle Blowing Policy; Risk Management Framework; The legal and

aimed at listed companies and wholly owned subsidiaries of listed companies, to establish higher standards of corporate governance in the country.[126]

Corporate Governance Voluntary Guidelines 2009: Recently, in December 2009, the *Ministry of Corporate Affairs (MCA), Government of India* published a new set of Guidelines,[127] designed to encourage companies to adopt better practices in the running of boards and board committees, the appointment and rotation of external auditors, and creating a whistle blowing mechanism.[128] Public and private companies, particularly the bigger ones, may voluntarily adopt these guidelines.[129]

Recent Developments: On 7th May 2011, the apex court judgment in the *RNRL v. RIL* gas pricing case[130] established unequivocally that the production sharing contract between the government and RIL overrides any private memorandum of understanding arrived at between two individuals, refusing to give sanctity to the Memorandum of Understanding (MoU) signed between the two Ambani brothers.[131] This principle had to be established in the interest of corporate governance; otherwise it would have created havoc in the corporate world with promoters of public limited, coming together and signing MoUs without a care for the shareholders and other stake holders[132].[133]

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regulatory standards; Capability of Regulatory Agencies - Ensuring Quality in Audit Process; Liability of Directors and Employees; Institutional Activism etc.

[126] *Supra* note 68 at *pp.25-26*

[127] The guidelines are divided into the following six parts:

i) Board of Directors
ii) Responsibilities of the Board
iii) Audit Committee of the Board
iv) Auditors
v) Secretarial Audit
vi) Institution of mechanism for Whistle Blowing

[128] *Supra* note 68 at *pp.25-26*

[129] *Supra* note 68 at *p.27*

[130] Reliance Natural Resources Ltd. (RNRL) vs. Reliance Industries Ltd. (RIL)

[131] *"Corporate Governance in India: Aims and Objectives"*, Available at: http://newsdawn.blogspot.in/2012/01/corporate-governance-in-india-aims-and.html

[132] Till today the shareholders had not been pleased with the MoU entered into between Mukesh and Anil Ambani when they divided between themselves the empire created by their father, Dhirubhai Ambani. The second important aspect of the judgment is that the natural resources of a country belong to the government and the government has the right to price it and prioritize the beneficiaries. While it is a well known fact, even internationally, that natural resources belong to the government, the government as a monopoly has the sacred responsibility to put the interest of the nation before everything else when

Again in October 2011, the MCA[134] of India showed interest to commence a corporate governance index that would offer rankings to companies adopting governance standards as it wants to take forward the government's efforts towards better governance in companies.[135]

VI. Conclusion

Corporate governance is essential for proper functioning of economic growth - by increasing investment, decreasing corruption, and reducing wasting of limited resources.[136] The much awaited Companies Bill 2011 has begun to take shape with the recommendations of the Select Committee after its introduction in the Indian Parliament in 2009.[137] The new Bill endeavours to strengthen corporate governance,- by providing provisions to ensure ethical and vigilant activities of directors and other professionals in the company, bringing reforms in enforcement measures and mandating increased transparency and accountability in comparison to the Companies Act 1956.[138]

Convergence of best corporate governance norms should be welcomed and incorporated as it signals broad acceptance of few best standards from all over the world. Indian corporate governance is comprehensive in nature as it's a blend of laws, market, codes etc unlike the US and UKs system who focuses mainly on stronger legal protection. Indian companies should pursue the way Infosys is following as today it has made a mark in the international market by its best corporate governance practice.[139]

It may be concluded that corporate governance should be committed towards corporate social upliftment, social responsibility and environment

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deciding on its use and sale price. This is where the judgment has implications that go beyond the Ambani brothers. Hence the apex court that the gas in this case belongs to the government and RIL is only a contractor who can market the product. But it will be the government that will decide at what price it should market it, and to whom it should market it. This is a double-edged sword.

[133] *Supra* note 130

[134] The Ministry of Corporate Affairs

[135] *Supra* note 130

[136] *Supra* note 70

[137] *Ibid*

[138] Vijay, Pavan Kumar., *"New Companies Bill takes ethics to a newer level"*, (2011), Daily News Analysis, Available at: http://www.dnaindia.com/analysis/column_new-companies-bill-takes-ethics-to-a-newer-level_1631374

[139] Unlike Satyam who has lost all its trust not only in the Indian market but also at the international level due to its bad corporate governance conduct.

protection, adding value to the various stakeholders.[140] The concept hinges on total transparency, integrity and accountability of the management and the board of directors.[141] Corporate Governance is a means and not an end, being corporate excellence the desirable end, since its importance of lies in its contribution both to business prosperity and to accountability.[142]

[140] Soni, Sonali., *"Corporate Governance in India – Past, Present & Future by Sonali Soni"*, (2010), Available at: http://www.indiacsr.in/en/?p=2630

[141] *Ibid*

[142] *Ibid*