

Regulatory and Economic Legislations – A foundation for strong Corporate Governance

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Company is a form of business organization formed generally for carrying out large business. The basic principle of incorporation is that for all purposes a company should be regarded as a separate entity independent of its shareholders. Subject to regulatory measures, the companies have full freedom in their functioning and have proved to be effective form of business for development.

As per the Annual Report 2007-08 of Ministry of Corporate Affairs, Government of India 7,43,678 companies limited by shares were at work in the country as on 31.03.2007. These comprised 7,42,009 non-government companies and 1,669 government companies. Out of 7,43,678 companies limited by shares at work, 90,654 companies were public limited and 6,53,024 were private limited companies. Besides, there were 3,846 companies with liability limited by guarantee and associations not for profit and 520 companies with unlimited liability as on 31.03.2007. The above figures are indicative of the crucial role which the corporates play in the development of the country.

Companies enjoy substantial rights over other forms of business. However, for every right there is a corresponding duty and the government has framed regulatory legislations for corporate governance. The purpose of regulation is only to ensure that business is carried on in a lawful manner. The regulations cover all the phases of company i.e. from incorporation to winding up. In India the key

*** Address by Mr. Justice G.N. Ray, Chairman, Press Council of India on “Regulatory and Economic Legislations- A foundation for strong Corporate Governance” organised by Amity International Business School Campus, Sector-44 , Noida on February 25, 2009**

legislation under which the companies operate is the Companies Act 1956 which is voluminous and contains elaborate provisions.

In this age of globalization when financial capital moves across national borders, it is necessary for the investors to ensure that the enterprises or the markets in which they are investing are not only managed competently, i.e. good corporate management, but they are also governed properly.

The concept of corporate governance which has caught the interest and imagination of all segments of the corporate world needs proper understanding. Governance has assumed greater significance in view of series of corporate failings, both in public and private sectors in India and elsewhere. There has been loss of faith in the infallibility of governance systems not only in India but elsewhere on account of liquidation of giant corporate houses and scandals of Enron, Tyco International, Adelphia and recently of Satyam in India.

The minimum benchmark of ethical and legal standards of regulation is being debated by experts in the corporate sector. Corporate governance is recognised as a medium to provide the structure through which the objectives of the company are set, to the means of attaining those objective and monitoring performance. Corporate governance consists of a system of structuring, operating and controlling a company in order to achieve objectives like fulfilling the strategic goals of the shareholders, expanding business activities both horizontally and laterally, taking care of the interest of employees, maintaining sound relations with customers and suppliers, taking account of community and environmental needs and also maintaining proper compliance with legal and regulatory requirements. Corporate governance addresses three basic disciplines: self-discipline, market discipline and regulatory discipline. Companies should develop a culture of transparency and accountability. Audit aims in bringing

transparency in the working of a company and to strike of a balance between risks and responsibilities. Disclosure should focus on quality of data, rather than quantity. The choice of regulatory pressures both statutory and self imposed are for ensuring proper development of the company and to eradicate improper functioning by the management.

In the era of globalisation Indian companies must strive to match global standards of governance. The systems should prevent corporate misconduct and ensure balanced functioning of the company. The new regulatory measures and rules for better governance of the Corporate Sector in India must address the global trend and Indian ground realities.

The Companies Act, 1956 contains various safeguards some of which are as follows:

(i) The Balance Sheet and the Profit and Loss Account should give true and fair view as per section 211(1) and section 211(2) respectively. Section 211(7) contains the penalty for willful non compliance of the obligations under Section 211.

(ii) Section 235 to 251 deals with investigation of the affairs of the company. Sections 397 to 407 empower the Court and Section 408 and 409 of the Companies Act, 1956 empower the Central Government to prevent oppression and mismanagement.

(iii) Section 433 empowers the court in its discretion to order winding up of a company inter alia, where the court is of the opinion that it is just and equitable to wind up the company. This gives the court discretionary power to wind up company when the circumstances warrant such action keeping the interest of members, creditors, employees and public in account.

However, in spite of various laws, rules and regulations, the corporates are still vulnerable to financial scandals. Very recently the most bewildering corporate fraud admission by Satyam promoter went

public, revealing enormity of malpractices and siphoning funds of the company systematically. The accounting scandal has shaken the confidence of foreign investors and lenders, besides discrediting corporate governance in India. The fear is that Satyam may not be an isolated case. The enormity of Satyam scandal has revealed the urgent need to relook at our regulatory and legislative framework which may require overhauling in the following areas: a stricter accounting, legislative change to financial reporting practice and corporate governance. The investors have to be protected by improving the accuracy and reliability of disclosures, pursuant to the securities laws, auditor's responsibility and liability in the event of lapses on its part internal assessment, enhanced financial disclosure, analysis of conflicts of interest, monitoring the activities of the accounting profession, besides making the CEO and CFO liable for white collar crimes.

Satyam Scandal has taken the Indian corporate sector by storm and has made serious dents in the credibility of the Indian corporate sector. It has raised serious questions regarding adequacy of checks and balances in the field of corporate governance in India. The Satyam incident has compelled experts as also the political establishment to rethink about the provisions in force to ensure transparency and propriety in corporate dealings. It has raised serious questions regarding adequacy of checks and balances in the field of corporate governance in India.

Although it may not be practicable to formulate measures which in all events provide full proof check on corporate scandals, some measures certainly will reduce the possibility of deliberate malfunctioning of corporate sector.

The law makers should debate and comprehensively overhaul the framework of corporate governance. Over doings and unnecessary government intrusion into corporate management thereby Indian

corporates at competitive disadvantage with foreign firms should be avoided. There should be increased accountability and improvement in financial controls. Some of the key challenges which could determine the shape of corporate governance may be indicated:

Stricter conditions for appointment of independent directors including divesting promoters from such appointment decisions, stricter conditions on conflicts of interest, enhancement of penalty for white collar crimes and conspiracies, specific provisions for criminal action for fraud by manipulation, destruction or alteration of financial records or other interference with investigations.

Independence of audit committee — Amending of the Companies Act to build safeguards for transparent functioning of board committees including audit committee and public disclosure of the committee's findings. There should be audit partner rotation and there should be restriction for auditing companies from providing non-audit services (e.g., consulting).

Empowering SEBI — Reserving participation of SEBI and giving it power in formulating and monitoring accounting standards for listed companies resulting in transparency in disclosure of financial information to stakeholders. Coordination between Ministry of Company Affairs, Ministry of Finance and ICAI for stricter accountability of auditors.

Appointment of a agency to oversee and inspect the auditors' functioning and reporting procedure and independent review of the accounting firms' opinion of public companies' financial health.

Strengthening Serious Fraud Investigation Office —more powers to the Serious Frauds office for expediting investigation and appropriate deterrents for similar frauds.

In the current scenario of worldwide recession and unemployment, regulatory body for corporate sector must be strict and prompt action should be enforced whenever needed.

Even though the need for effective regulation of Corporate Sector cannot underestimated but market discipline alone is not sufficient to prevent the occurrence of insider dealing, market manipulation and cheating or fraud. The investors should be protected through greater public education and disclosure rules and untainted corporate communication.

The Chartered Accountants Act should be immediately amended comprehensively and, if necessary, replaced by a new legislation making auditors conducting statutory audit in a company accountable to an Ombudsman to be set up by statute. The disciplinary powers relating to auditors should be vested in a statutory authority comprised of, inter alia, eminent experts in the concerned fields.

Necessary amendments should be made to The Right to Information Act, 2005 making it obligatory for companies having share capital above a specified limit or holding public deposits above a specified limit liable to disclose information under The Right to Information Act, 2005.

I am quite optimistic, that given the right and balanced environment, the Indian corporates will function properly and will generate national wealth and plough back part of the profits for the welfare of the society.
