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LEGAL ASPECTS OF CORPORATE GOVERNANCE FOR IT COMPANIES IN INDIA

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ABSTRACT

Corporate governance has gained momentum worldwide due to business failures miserable, the unethical business practices and inadequate disclosure etc. Effective corporate governance depends on two factors. Transparency in business operations and the second is the legal and administrative framework created by the government. There is a gap between percept and practice of Corporate Governance. In this paper attempt has been made to develop the mechanisms of corporate governance in the context of the legal framework in India, particularly the way in which Article 49 of the Listing Agreement act as an opportunity for companies listed on scholarship to achieve IT governance. This study aims to better understand how major regulatory changes affected practices of corporate governance in India.

KEYWORDS: Corporate Governance, Clause 49 and IT Governance

INTRODUCTION

Corporate governance is largely a set of mechanisms by which outsider investors protect themselves against expropriation by insiders (La Porta et al, 2000). The topic of corporate governance has attracted attention since the 1980s and especially after the code of corporate governance issued by the Cadbury Committee. In agreement with the Cadbury Committee, the Kumara -mangalam Birla Committee, also published a code of corporate governance for companies in India. According to Kumara-mangalam Birla Committee it is the system by which companies are directed and controlled.

LEGAL FRAMEWORK IN CORPORATE GOVERNANCE

The Indian companies have to comply with the provisions of the Companies Act 1956, SEBI guidelines, the Kumara mangalam Birla report on corporate governance, accounting standards issued by the ICAI and listing agreements with the stock exchanges in which they are listed.

The Companies Act 1956 is the legal instrument applicable in India governing the establishment, operation and liquidation of companies. Ordinary business as declaration of dividends, appointment of directors, the acceptance of the financial statements and the appointment of auditors requires the consent of 51% of shareholders, while all other business activities (other than routine business) requires the approval of 75% of shareholders. If a company wants to start a new business that requires the approval of 75% of shareholders, which means that, the board of a widely held company must be able to convince shareholders about his strategy to pass the special resolution.

KMB report states that the Council consists of atleast 50% of the non-executive directors. If the president and chief executive then atleast half of the board of directors must be independent and in the other case must be atleast one-third of the total directors be independent. It is noteworthy that the law there should be a minimum of 3 directors and a maximum in any case to be behind 12 only after obtaining the approval of the central government. It further states that any

person can be a director of more than 20 companies. The report was taken KMB viewpoint more stringent that the administration should not be members of more than 10 committees or chairman of more than 5 committees in all the companies.

The Institute of Chartered Accountants of India is the appropriate authority to issue accounting standards that are required in most cases. As of now we have 28 rules that provide guidelines for the disclosure of financial information to ensure consistency between the companies.

The Securities and Exchange Board of India is the regulatory authority that issues the regulations, standards and guidelines for companies to ensure investor protection. The shares trade on the stock exchange companies must comply with additional requirements as mentioned in the sale agreement on a regular basis.

Pre Liberalization

During the early indigenous organizations were forced by colonial rule and most of the rules and regulations catered to the whims and fancies of British employers. The Companies Act was introduced in 1866 and was gradually revised in 1882, 1913 and 1932. Law Association of India first introduced in 1932. The various programs that were in his approach handled corporate agency model case as individuals / commercial firms entered into legal contracts with corporations. It was characterized by the abuse / misuse of the responsibility for the management agent due to dispersed ownership. The issues of generation and gain control were squandered leading to several conflicts.

The period of the 1950s and 1960s was a period of commissioning of industrial activities and costs, as well regime. The genesis was the demand of many products for which the government administers Fair Prices. This was the time when the Tariff Commission and the Bureau of Industrial Costs and Prices were set by the Government. 1951 - Development Regulation Act of India 1956 - Companies Act came into existence. Development institutions and banking came into existence. The period from the 70s to the mid-eighties was a time of cost-volume analysis results, as part of the Cost Accounting function.

Post Libralization

After liberalization, India has been thoroughly considered by organizations / companies around the world to create new markets. Progressive Indian companies have made an attempt to put the corporate governance systems in place. There have been several discussions and events leading to the development of corporate governance. The basic minimum corporate governance code has been proposed by the Chamber of Indian Industries (CII), guiding 1998.

The First Phase of India's Corporate Governance Reforms: 1996-2008

The first phase of corporate governance reforms in India goes to the boards and audit committees -Make more independent, powerful and monitors management and help shareholders, including institutional investors and foreign focused on the monitoring management. These reform efforts were channeled through a number of different ways with SEBI and MCA both play an important role.

1998 - Confederation of Indian Industry (CII)

CII took a special initiative on corporate governance - the first institutional initiative in Indian Industry. The aim was to develop and promote a code for businesses - be in the private sector, public sector banks and financial

institutions. CII initiatives flowing from public concerns about protecting the interests of investors, especially small investors; promoting transparency in business and industry; the need to move towards international standards on disclosure of information by the business sector, and through all this to develop a high level of public trust in business and industry.

1999- Report of the Committee (Kumar Manglam Birla) on Corporate Governance

The commission's report is a set of recommendations that distinguishes the responsibilities and duties of the board and management in the institution of corporate governance systems and emphasizes the rights of shareholders in the demand for corporate governance. Many of the recommendations are required. It is hoped that these recommendations be applied to listed companies for initial and continuous disclosures gradually within specified dates, through the sale agreement. It will also require firms to separately disclose in their annual reports a report on corporate governance outline the steps they have taken to implement the recommendations of the committee. These allow shareholders namely where companies, which have invested, stand with respect to specific initiatives to ensure sound corporate governance.

November 2000- Report of the Task Force on Corporate Excellence through Governance

Department of Company Affairs prepared a report on the achievement of business excellence through governance. Depending on the size and capabilities of enterprises and requirements of the market place, the working group recommended implementations eliminated the essential measures.

2000 – Enactment of Clause 49

Shortly after the introduction of the CII Code, SEBI appointed the Committee on Corporate Governance (the Birla Committee). In 1999, the Birla Committee submitted a report to SEBI: to promote and raise the standard of Corporate Governance listed companies. Birla Committee recommendations-enhance function key objectives focused mainly on two and directory structure businesses and increasing shareholder information. As for the boards, the committee made specific recommendations regarding board representation and independence that have persisted to date in Clause 49. Among other recommendations, the Birla Committee stated that a company's annual report to shareholders must contain a section analysis (MD & A) and Management Discussion and companies must convey certain information, such as quarterly reports and analyst presentations to shareholders.

March 2001 – RBI – Report of the Advisory Group on Corporate Governance: Standing Committee on International Financial Standards and Code

The governance mechanism differs in each country and is made up of political, economic and social history, as well as its legal framework. With great interest shown by organizations such as the World Bank, the Asian Development Bank, etc, the OECD developed a set of internationally recognized principles to serve as good reference points. The CG advisory group sought to compare the situation of corporate governance in India vis a vis the best internationally recognized standards and suggested to improve corporate governance standards in India.

April 2001 – RBI – Report of the Consultative Group of Directors of Banks/Financial Institutions

The consultative group of directors of banks and financial institutions established by the Reserve Bank to review the supervisory role of boards of directors of banks and financial institutions and to obtain feedback on the operation of the boards vis a vis compliance committees, transparency, disclosure, auditing, etc. and make recommendations to the role of

the board of directors more effective in order to minimize risk and exposure. Following international best practices as recommended by the Committee on Banking Supervision, the Committee recommended a review of the current framework governing the establishment of boards of banks and financial institutions.

December 2002 –Report of the Committee (Naresh Chandra) on Corporate Audit and Governance Committee

The committee took on the task of analyzing and recommending changes in areas such as: the statutory auditor - company relationship, the procedure for the appointment of auditors and determination of audit fees, restrictions-if necessary on the price of not hearing, measures to ensure that the management and companies put forth a fair statement true and 'financial affairs of the company. He also reflected on other measures such as certification of accounts and financial statements of management and administration. The committee aims to study and build on its report following the benchmarks set by the Sarbanes Oxley Act (SOX).

February 2003 (N. R. Narayan Murthy) – SEBI Report on Corporate Governance

The Securities and Exchange Board of India (SEBI) in its effort to improve the standards of government constituted a committee to study the role of independent directors, related parties, risk management, counselor and director compensation, codes of conduct and financial disclosure. The committee based its recommendations on various parameters such as fairness, accountability, transparency, ease of implementation, verifiability and applicability.

July, 2003 (Naresh Chandra Committee II) Report of the Committee on Regulation of Private Companies and Partnerships

The Companies Act of 1956 was based on the environment that includes the license and permit Raj in India. The act has been amended more than two dozen times, taking into account the various changes in the business environment. As a large number of private sector firms, came to the picture that there was a need to revise the law again. To take advantage of this framework, the government formed a committee in January 2003, to ensure scientific and rational regulatory environment. The main objective of this report was a) The Companies Act; 1956 b) The Indian Partnership Act, 1932.

Clause 49 Amnedments

In 2004, SEBI further amended Clause 49, in response to the recommendations of the Murthy Committee. However, the implementation of these changes was delayed until January 1, 2006, primarily due to industry resistance and lack of readiness to accept this type of comprehensive reforms. While there were many changes in Clause 49, as a result of Murthy Report, government requirements regarding corporate boards, audit committees, disclosure of shareholders and the CEO / CFO certification of internal controls are as transformation of governance standards and disclosure Indian companies.

Clause 49, Currently in Effect, Includes the Following Key Requirements

- Independence Board Meetings of listed companies must have a minimum number of independent directors. When the President is an executive or a promoter or related to a promoter or a senior official, at least half of the board should comprise independent directors; in other cases, independent directors must constitute at least one-third the size of the board.

- Audit committees of listed companies must have audit committees of the board with a
- minimum of three directors, two-thirds of whom must be independent; addition, the roles and
- responsibilities of the audit committee are specified in detail.
- Listed companies must periodically release various disclosures regarding financial and other measures to ensure transparency issues.
- Certification CEO / CFO of internal controls of the CEO and CFO of listed companies must

  (a) certify that the financial statements are fair and

  (b) be responsible for internal controls.
- Annual Reports of listed companies must make reports on compliance with corporate governance standards.

The Second Phase of Reform: Corporate Governance after Satyam

The business community of India experienced a significant shock in January 2009 with damaging revelations about motherboard failure and colossal in the financial statements of Satyam fraud. The Satyam scandal also served as a catalyst for the Indian government to rethink corporate governance, disclosure, accountability and enforcement mechanisms in place. As described below, the Indian regulators and industry groups have called for a number of corporate governance reforms to address some of the concerns raised by the Satyam scandal. Industry response shortly after news of the scandal broke, the CII began to examine corporate governance issues arising from the Satyam scandal. Other industry groups also formed corporate governance and ethics committees to study the impact and lessons of the scandal. In late 2009, a working group extended CII recommendations for reform of corporate governance. In its report, the CII emphasized the unique nature of the Satyam scandal, noting that -Satyam is an isolated incident. The vast majority of Indian companies are well managed, well regulated and does business in a sound and legal manner. In addition to the CII, the National Association of Software and Services Companies (NASSCOM, describes himself as -the premier trade body and the chamber of commerce of the IT-BPO industry in India also formed a Corporate Governance and Ethics Committee, chaired by NR Narayana Murthy, one of the founders of Infosys and a leading figure in the reform of corporate governance in India. The Committee issued its recommendations in mid-2010, focusing on the stakeholders in the company. The report focuses on the recommendations relating to the audit committee and a policy of complainants. The report also addresses the improvement of the rights of shareholders. The Institute of Company Secretaries of India (ICSI) has also presented a series of recommendations on corporate governance. The government's response Satyam prompted swift action by both SEBI and MCA.

SEBI actions In September 2009, the SEBI Committee on Disclosures and Accounting Standards issued a working paper examined the proposals for:

- appointment of the chief financial officer (CFO) for the audit committee after assessing the qualifications, experience and background of the candidate;
- Rotation of audit partners every five years;
- Voluntary adoption of International Financial Reporting Standards (IFRS); Interim disclosure of balance sheets

(audited figures of the major heads) on a semiannual basis; and

- streamlining the deadlines for submission of various financial statements of listed entities pursuant to the sale agreement

In early 2010, amended the SEBI Listing Agreement to add provisions relating to the appointment of the chief financial officer of the audit committee and other related financial disclosure matters. However, other proposals such as the rotation of audit partners were not included in the amendment of the agreement of sale. MCA shares Inspired by industry recommendations, including recommendations influential CII, in late 2009, the MCA issued a set of voluntary guidelines for corporate governance. Voluntary Guidelines address a variety of corporate governance issues, including:

- the independence of boards of directors;
- responsibilities of the board, audit committee, auditors, audits secretariat;
- and mechanisms to encourage and protect whistle blowing.

Important Provisions Include

- The issuance of a formal letter of appointment for directors.
- Separation of president and CEO.
- Institution of a nomination committee for the selection of directors.
- Limiting the number of companies in which a person can become a director.
- Tenure and remuneration.
- Training directors.
- Performance evaluation of principals.

In discussing the voluntary nature of the guidelines, the Secretary of Corporate Affairs R. Bandyopadhyay said the MCA would not enact a rigid, mandatory law. However, the MCA also indicated that the guidelines are a first step and that the option is open to move perhaps more mandatory.53 Indeed, certain aspects of volunteering, such as the dismissal of Chairman and guidelines delegate, have now been recommended for enactment of the amendments to the Companies Act pending in Parliament.

IMPACT OF CLAUSE 49 ON IT GOVERNANCE

Most business entities in India have witnessed a strong penetration of IT in managing business processes. Entrepreneurial careers have gone massive enterprise resource state of the art planning (ERP) implementations through its business geographically dispersed locations, harvesting the registry online trading transactions and the availability of information a mouse click. The major ERP vendors have come out with India-specific versions to serve its growing customer base in India. Adding momentum to this development is the growing offshore (and often intercontinental) acquisitions of business units most of the top business houses in the last year, in the services and manufacturing verticals. The cumulative effect of all these developments is down to the fact that the way to corporate governance definitely passes the achievement of IT governance. Many business entities in India have begun to recognize the importance of having a

chief information officer (CIO) working independently and reporting directly to the Board, rather than the traditional structure information and work under reporting to the CFO. This has lent a sense of urgency to make the IT function of their rightful place in the scheme of handling things.

IT Governance (IT Governance) ensures correct decisions and accountability framework to encourage desirable behavior in the use of IT. IT governance reflects the broader principles of corporate governance while focusing on the management and use of IT to achieve the goals of business performance. Because IT results are often difficult to measure, companies should assign responsibility for desired outcomes and assess how well they achieve them. IT Governance should not be considered in isolation as it is linked to other key assets of the company (ie human, financial property, intellectual, physical, and relationships). Therefore, IT governance can be shared with other mechanisms of the processes of government and coordinating the processes of decision making across the enterprise. When a governance structure carefully designed and implemented no lack harmony and the company is left to chance. (Weill and Ross, 2004). Government should include an approach to exception handling and continuous improvement.

CONCLUSIONS

Since the late 1990s, considerable efforts have been taken by the regulators in India, as well as representatives from industry and Indian companies to review corporate governance in India. Not only was the reform measures were put in place before the discovery of the great scandals of corporate governance, but the two industry groups and government actors have sprung into action after the Satyam scandal. The current system of corporate governance in India at the end of both voluntary and mandatory requirements. For listed companies, it is required that the vast majority of the requirements of clause 49. It remains to be seen whether some of the latest corporate governance measures voluntary becomes mandatory for all companies through a comprehensive review of the Act Corporations.

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