Corporate governance issues post Satyam - a brief

Jai Prakash Sharma
Department of Commerce, Delhi School of Economics, University of Delhi, India

Abstract

The Satyam fraud has shattered the dreams of lakhs of investors, shocked the government and regulators alike and led to questioning the accounting practices of statutory auditors and corporate governance norms in India. Severe corporate governance problems emerge out of the above-mentioned corporate wreckage. Unethical business conduct and behavior; promoters and senior management involved into cooking of books, accounts and insider trading; unwarranted acquisitions; failure of external audit; questionable role of audit committee and rating agencies; laxity on the part of board; unconvinced role of independent directors; false disclosures; promoter's pledging of shares; flawed ownership model; etc, are the major governance problems/flaws noticed in the collapse of Satyam. Many of these governance problems were noticed in several other such corporate failures in USA, UK and Europe. These countries reacted strongly to the corporate failures and codes & standards on corporate governance came to the centre stage. Corporate scandals especially in the United States triggered reforms in corporate governance, accounting practices and disclosures the world over. Enron debacle in 2001 and number of other scandals involving large US companies such as the Tyco, Quest, Global Crossings, World.Com and the exposure of auditing lacunae, which led to the collapse of the Andersen, set in motion the corporate governance reform process and resulted in the passing of the Public Accounting Reform and Investor Protection Act, 2002 in USA (known as Sarbanes-Oxley Act, 2002). The main objective of the Oxley Act is to repose investor's confidence by preventing corporate frauds and ensuring transparency and disclosures. Similar kinds of corporate governance reforms are needed in India too. There is need to reform corporate governance in India by taking harsh policy measures. Following kinds of actions call for immediate attention to improve corporate governance in the country: ethics code in listed companies; independent regulatory body to monitor auditors, rotation of external auditors, Introduction of new audit standards, divulging details of auditors to banks, reforming audit education; abolishing practice of nominating independent directors, exempting independent directors from vicarious liability, providing insurance cover to independent directors, reviewing definition of independent director given in clause 49; discloser of promoter's pledging of shares; close supervision of rating agencies; allowing companies to adopt IFRS voluntarily; prohibiting political funding; installing whistleblower mechanism; introducing class action suit & compensation; having in place permanent PPP system; and enhancement in criminal and civil penalties. Even though corporate governance mechanisms cannot prevent unethical activity by top management completely, but they can at least act as a means of detecting such activity before it is too late. When an apple is rotten there is no cure, but at least the rotten apple can be removed before the infection spreads and infects the whole basket. This is really what effective governance is about.