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Harpreet Kaur *Editor*

Facets of Corporate Governance and Corporate Social Responsibility in India

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Editor

Facets of Corporate Governance and Corporate Social Responsibility in India

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Preface

The edited book *Facets of Corporate Governance and Corporate Social Responsibility in India* offers 14 chapters on corporate governance, corporate social responsibility and governance in general. The chapters have been covered in three parts in the book, namely, Part I-Corporate Governance, Part II-Governance and Part III-Social Responsibility. The chapters are contributed by authors including academicians, lawyers and professionals. The chapters are modified papers that were presented by their respective authors in the International Conference on Governance, Fraud, Ethics and Social Responsibility held at National Law University Delhi.

The term 'Corporate Governance' is defined in many ways from different perspectives. It is an inevitable expression used in reference to companies. In this context, an introductory chapter has been added by me which provides brief information on developments in corporate governance in India. This chapter will be helpful in establishing a background for the understanding of readers.

The first chapter in Part I is on 'Shareholders' engagement and sustainability of companies'. It covers the review of Shareholders' Rights Directive (2007/36/EC) by the European Union and was presented by me in the same conference as the keynote speech. It provides a brief description of five major issues dealt with by the directive and discusses India's position in this regard. The areas covered by the review include identification of shareholders, institutional investor engagement, transparency by proxy advisors, right to vote on remuneration and related party transactions, Chapter Two lays down the connection between corporate governance failures and increasing corporate frauds in India. It has covered legal provisions as well as many fraud cases. Chapter three takes a look at the mitigation of white-collar crimes and explores different mechanisms that are used globally. While exploring such different approaches, the authors have suggested that global regulatory developments for fraud deterrence and control provide a scalable benchmark for India. Chapter four on audit quality indicators has been co-authored by two academicians from Turkey. The authors have made an effort to suggest inspection of electronic environment and public disclosure of audit quality indicators. Independent audit authorities of Turkey and Public Oversight, Accounting and Auditing Standards Authority- KGK have been referred by the authors in the chapter. The last chapter of Part One decodes corporate governance and insolvency-related issues in India. The authors have covered the role of directors and promoters, who bid during a resolution process and analysed the impact of such bids on the insolvency proceedings. They have suggested measures to improve the status quo to make corporate governance and insolvency more stable in India.

In Part II, three chapters covering different aspects of governance have been added. In the first chapter, the author has conceptualized citizens' involvement in governance and has re-examined encounters of effective resident interest in urban administration. The second chapter provides information on environmental governance. The authors have examined the environmental degradation due to relentless industrialization and provided suggestions for deterring environmental pollution. The third chapter discusses Shari'ah governance as a way to improve the corporate governance. In the opinion of authors, Shari'ah governance encourages honesty, integrity, transparency, accountability, and responsibility among stakeholders in an organization. Therefore, the authors suggest that such principles can be used for reducing corporate frauds and scams.

Part III includes five chapters on Social Responsibility. The first chapter shares a South African perspective on deduction of Corporate Social Responsibility (CSR) expenses written by Prof. H. J. Kloppers, who has contributed a lot in the field of CSR through his writings. In the second chapter, the author has explored the role of government in CSR. The author has attempted to identify and compare the government regulations on corporate behaviour for promoting corporate social responsibility. She has also examined some jurisprudential questions in this regard. In the third chapter, the legacy of CSR in India has been traced by the author by examining corporate organisations of ancient India. She has examined the factors behind the establishment of Sreni as an economic, political, financial and legal entity. CSR and issues relating to taxes have been discussed by an author in the fourth chapter. The author has provided her inputs on CSR spending and has tried to establish a linkage between CSR spending and tax policy. The last chapter in the book includes the discussion on Socially Responsible Investments in India and also discussed the significance of Green Investment strategy.

You would agree with me that the chapters have covered varied aspects of corporate governance and corporate social responsibility. I am sure that chapters would provide additional knowledge and information to the readers. Happy reading!

New Delhi, India

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Acknowledgments

Many people have contributed towards the final work, which is being presented to the readers in the form of the book—'Facets of Corporate Governance and Corporate Social Responsibility in India'. I wrote in the preface that these chapters are modified papers presented by their respective authors in the Ninth International Conference on Governance, Fraud, Ethics and Social Responsibility held at National Law University Delhi. The conference is organized annually by Trakya University, Turkey, in different countries across the globe. The opportunity to host the Ninth conference was provided to me by its founding member, Prof. Kiymet Caliyurt Tunca, Trakya University. I met Prof. Kiymet during the first conference in the series at Trakya University, Edirne, where I presented my paper in 2009. Neither of us could have predicted in 2009 that the ninth conference would be organized in India in 2018. Therefore, my first vote of thanks is for Prof. Kiymet for providing the opportunity for hosting as well as contributing the edited book in her series.

I am thankful to Prof. (Dr.) Ranbir Singh, former Vice-Chancellor for his permission to host and providing his whole-hearted support to the conference. I am also thankful to Prof. G. S. Bajpai, Registrar of National Law University Delhi for his support in the execution of the conference. The administrative staff of National Law University Delhi worked late and extra hours for providing technical and administrative support to the conference. Due to their consistent efforts, arrangements of the conference were appreciated by all the participants. My thanks to my colleagues, who provided their support during the conference.

I express my gratitude for all chapter writers without whose contribution this edited book was not possible. My sincere thanks to them for answering editorial comments and revising their work whenever I wrote to them. A lot of work has been done by the students' editorial team, which was appointed by me for initial editing of chapters. The members of the editorial team included Mr. Abhishek Anthwal, Ms. Manaswini, Mr. Neeraj Nainani and Mr. Yuvnesh Sharma. The student coordinator, Ms. Ipsita Pallavi Sahoo, of the Centre for Corporate Law and Governance provided her full support for the conference and paper presentations. I am happy to share that all five students have graduated successfully this year. My research associate, Ms. Ankita Sangwan has assisted me during the entire journey.

My special thanks to Prof. SKD Rao, the present Vice-Chancellor of my university for his support. There would be a few others whom I may have forgotten to mention. I would like to thank one and all, who helped me in bringing out this edition.

With gratitude,

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Developments in Corporate Governance in India

Abstract The chapter on 'Developments in Corporate Governance in India' is providing an introduction to the readers how regulation of corporate governance has evolved in India. The chapter has covered a legal framework and has incorporated brief information about various committees that were set up in India for improving corporate governance. The chapter has also shared a few current practices that have raised serious concerns on corporate governance in India.

Keywords India Business Responsibility Report • Code of Conduct • Corporate Governance • Kotak Committee • Listing Agreement • Shell Companies • Stewardship Code

Introduction

A new Companies Act, 2013 (CA, 2013) was enacted by India replacing the Companies Act, 1956. The CA, 2013 was adopted in order to improve corporate governance and transparency through more disclosures and compliances. The codification of duties of directors, recognition of beneficial ownership, protection of minority shareholders and class action are some of the thrust areas of the new Act. India, being a British colony in the past, has been following developments in English Company Law. The first Joint Stock Companies Act in India came in 1850. The erstwhile Companies Act, 1956 was amended repeatedly but remained enforced for around 50 years.[1] The present CA, 2013 was enacted after the English Companies Act, 2006 was adopted in the UK. India globally is ranked third in terms of family businesses.[2] Indian companies are promoter-driven companies with concentrated ownership in

[1]The Companies Act, 1913 was repealed by the Companies Act, 1956. The Companies Act, 1956 was enacted on the recommendation of the Bhabha Committee, which was constituted in 1950 to provide comprehensive legislation for corporate law in India.

[2]India ranks third globally in terms of the number of family-owned businesses with 111 companies of $839 billion total market capitalization as per a report published in 2018, Business Standard, PTI, Sept 14, 2018.

the hands of promoters and promoter groups. Cross shareholding is also present both vertically through subsidiary parent relations and horizontally through associate and group companies. A number of measures have been undertaken over the years by the Ministry of Corporate Affairs and the Securities and Exchange Board of India (SEBI) to improve corporate governance in India listed companies.[3]

Corporate Governance Developments in India Before CA, 2013

The discussion on corporate governance in India began in 1998 with a voluntary Code of Corporate Governance developed by the Confederation of Indian Industries (CII).[4] The CII had constituted a task force for drafting the desirable code for corporate governance in 1996 for promoting investor protection in all types of companies. This was the first institutional initiative towards improving corporate governance in India.

The Code was followed by the Kumar Mangalam Birla Committee Report on corporate governance in 1999. The committee was constituted by the SEBI to promote and raise the standards of corporate governance in Indian companies.[5] Its recommendations were divided into mandatory and non-mandatory recommendations. The mandatory recommendations were considered to be essential for improving corporate governance. Such recommendations were proposed by amending the listing agreement, which every listed company is required to make with the Stock Exchange for listing its securities.[6]

In the next phase, the SEBI introduced a new clause 49 in the listing agreement of the stock exchanges along with certain principles of corporate governance. They were made applicable in a phased manner over a period of 3 years.[7] Clause 49 which contained requirements for improving corporate governance in listed companies was amended many times on recommendations of committees constituted from time to time. Clause 49 provided for disclosures and compensation of independent directors, qualified and independent audit committee, disclosures about related party transactions, accounting treatment, risk management, internal controls, certification of

[3]Ministry of Corporate Affairs is primarily concerned with administration of the Companies Act 2013, the Limited Liability Partnership Act, 2008 and other allied Acts and rules and regulations framed thereunder mainly for regulating the functioning of the corporate sector in accordance with law. http://www.mca.gov.in/MinistryV2/about_mca.html.

SEBI is the quasi-judicial regulator for the securities market in India. It has been given wide powers of calling for information and consent decrees by the Securities Laws (Amendment) Act, 2014. https://www.sebi.gov.in/about-sebi.html.

[4]The Code was developed on the lines of Cadbury Committee Report, UK.

[5]The Committee was constituted under the chairmanship of Mr. Kumar Mangalam Birla. The report of the committee is available at http://www.nfcg.in/UserFiles/kumarmbirla1999.pdf.

[6]Listing of securities is provided by the Securities Contract Regulation Act, 1956.

[7]Corporate Governance in listed Companies—Clause 49 of the Listing Agreement, available at https://www.sebi.gov.in/legal/circulars/aug-2003/corporate-governance-in-listed-companies-clause-49-of-the-listing-agreement_15948.html.

financial statements, etc. The Narayana Murthy Committee was appointed twice by the SEBI in 2002 and 2004 for improving clause 49.[8] The committee gave mandatory and non-mandatory recommendations for audit committee, related party transactions, risk management, code of conduct for Board of Directors and senior management, nominee and independent directors, compensation of non-executive directors and whistleblower policy.[9] The committee also decided to adopt mandatory recommendations in the report of the Naresh Chandra Committee (2002) related to corporate governance. Such recommendations were adopted through an amendment to clause 49.[10]

The Ministry of Corporate Affairs proposed the 'Corporate Governance-Voluntary Guidelines 2009' for voluntary adoption by the companies in India. These voluntary guidelines for improving corporate governance standards and practices were prepared on the basis of the recommendations of the task force set up by CII.[11]

Besides, the committees constituted by SEBI, the Ministry of Corporate Affairs was also continuously working towards strengthening the law. It constituted a Committee known as Irani Committee for advising the government on the revisions to the Companies Act, 1956.[12] The Committee felt the need for simplifying corporate laws to make them amenable to clear interpretation and provide a framework to facilitate faster economic growth.[13] The Companies Act, 1956 was a voluminous document with 781 sections and had failed to take into account the changes in the national and international economic scenario at a faster pace. It was also regarded outdated by the committee in some areas. The committee, however, was of the opinion that it had many essential features of corporate governance, which can be retained and articulated further. The committee recommended that the company law may be drafted in a manner that while essential principles are retained in the substantive law, procedural and quantitative aspects are shifted to the rules. This will assist the law to remain dynamic and adapt to the changes in the business environment. In view of the comprehensive suggestions given by the committee which made numerous amendments necessary, the Companies Bill, 2008 was proposed and finally after producing many bills, India enforced the Companies Act, 2013.

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[8]SEBI appointed Narayana Murthy Committee in 2002 and in 2004 for improving corporate governance.

[9]Report of the committee is available at https://www.sebi.gov.in/reports/reports/mar-2003/the-report-of-shri-n-r-narayana-murthy-committee-on-corporate-governance-for-public-comments-_12986.html.

[10]The Report of Shri. N. R. Narayana Murthy Committee on Corporate Governance, p. 12 available on https://www.sebi.gov.in/reports/reports/mar-2003/the-report-of-shri-n-r-narayana-murthy-committee-on-corporate-governance-for-public-comments-_12986.html.

[11]The task force was set up under the chairmanship of Mr. Naresh Chandra in 2009.

[12]Irani Committee was constituted on 2nd December 2004 under the chairmanship of Dr. J. J. Irani, Director, Tata Sons.

[13]Report of the Expert Committee on Company Law, 2005 available at http://reports.mca.gov.in/Reports/23-Irani%20committee%20report%20of%20the%20expert%20committee%20on%20Company%20law,2005.pdf.

Corporate Governance Developments in India After CA, 2013

The CA, 2013 focuses on investor protection and to achieve it the provisions relating to directors have been made stringent. It has provided the definition of independent directors, introduced the requirement of women directors, key managerial personnel, senior management and duties of directors. The code of conduct for independent directors has been included in Schedule IV of the Act. The appointment of independent directors is through a data portal maintained by the Central Government.[14] The definition of promoters has been given and the number of layers of subsidiary companies has been restricted to two except for investment companies. The presence of women directors improves gender diversity in the boards and it is believed that it would improve functioning and performance of boards. Therefore, every listed company, every public company having either paid up share capital of 1000 million or more or a turnover of 3000 million or more except for S. 8 companies has been required to have at least a woman director on its board under S. 149.[15] However, it was found that the requirement was complied with by around 25% companies bringing in women from promoter families as board members.[16]

After the enactment of Companies Act, 2013, the SEBI also replaced listing agreement requirements by bringing in SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. All listed companies for listing of their securities have to comply with the requirements of regulations. The regulations have also mandated for top 1000 listed companies on the basis of market capitalization to describe the initiatives taken by them from an environmental, social and governance perspective in their Business Responsibility Reports in their annual returns under regulation 34(f). This requirement was initially imposed on the top 100 listed companies to cover their activities related to environment and stakeholder relationships. Gradually it has been extended to top 1000 listed companies.[17]

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[14] Indian Institute of Corporate Affairs has been identified by the Central government for maintaining the data portal for selection of independent directors by companies.

[15] CA 2013, S. 8 companies are companies incorporated with charitable objects, etc.

[16] Rica Bhattacharya, 'Gender diversity on boards improves, but more ground needs to be covered: Expert' *The Economic Times* (Mumbai, 19 February 2018) https://economictimes.indiatimes.com/news/company/corporate-trends/gender-diversity-on-boards-improves-but-more-ground-needs-to-be-covered-experts/articleshow/62988324.cms?from=mdr accessed on 18 April 2020.

[17] Harpreet Kaur, 'Achieving Sustainable Development Goals in India' in Beate Sjåfjell and Christopher M Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press 2019); 'Business responsibility reports mandatory for top 1,000 listed companies: sebi' The Times of India (New Delhi, 20 November 2019) https://timesofindia.indiatimes.com/business/india-business/business-responsibility-reports-mandatory-for-top-1000-listed-companies-sebi/articleshow/72146106.cms accessed on 19 April 2020.

In 2017, the SEBI appointed a committee for improving corporate governance in listed companies known as 'Kotak committee.'[18] The committee gave its recommendations dealing broadly with the composition and role of Board of Directors, institution of independent directors, Board Committees, enhanced monitoring of group entities, promoters/ controlling shareholders and related party transactions, disclosures and transparency, accounting and audit-related issues, investor participation in meetings of listed entities and governance aspects of public sector enterprises. On the recommendations of the Kotak Committee, the SEBI mandated for top 1000 Indian companies to have one woman independent director on their Boards by 1 April 2020 and as of 03 March, 150 such companies by market value have not been able to appoint women independent directors.[19] However, in view of COVID-19, the date was extended to 30 June 2020.

The CII has recently circulated Guidelines on integrity and transparency in governance and responsible Code of Conduct, 2020. The Code of Conduct guidelines deal with integrity, ethics and governance, responsible governance and citizenship, role of high performing Board, balancing interests of stakeholders, independent directors and women directors, safe harbours for independent directors, easier settlement norms and amnesty provisions, risk management, succession planning, role of the audit committee, improving audit quality, and enhancing the accountability of third parties who play a fiduciary role, disclosure and transparency-related issues, vigil mechanism, stakeholder, vendor and customer governance, investor activism and start-ups and medium and small scale enterprises.

Issues Relating to Corporate Governance

A continuous and consistent effort to improve corporate governance in listed companies made by MCA and SEBI is visible in the Indian legal and regulatory framework. Even then, the corporate governance issues have been noticed which raise serious concerns. The problem of vanishing companies and the existence of shell companies

[18] The committee was constituted under the chairmanship of Mr. Uday Kotak.

[19] Rica Bhattacharya, 'Many NSE-listed companies yet to appoint women independent director' *The Economic Times* (Mumbai, 03 March 2020) https://economictimes.indiatimes.com/news/company/corporate-trends/many-nse-listed-companies-yet-to-appoint-women-independent-director/articleshow/74450113.cms?from=mdr accessed on 18 April 2020;

In Indian family businesses women average only 15% on the board and 13% on management teams, compared to 21% on the board and 24% in management teams across the globe, PwC India Family Business Survey 2019, p. 5, https://www.pwc.in/assets/pdfs/research-insights/fbs/2019/pwc-india-family-business-survey-2019.pdf; SEBI had appointed Kotak Committee for improving standards of Corporate Governance in listed companies in India under the chairmanship of Mr. Uday Kotak on June 2, 2017.

have been a persistent issue in India.[20] Besides being used in money laundering, such shell companies are also instrumental in reverse mergers. In response to the question raised in upper house of Indian Parliament, it was shared that 0.0297 million companies were identified as shell companies as on 31.03.2017 and after following due process names of 226,166 companies were struck off from the register of companies by 31.12.2017.[21] Registrar of Companies has the power to remove names of such companies from the register under s. 248, CA, 2013.[22] After a drive to strike off shell companies, the compliance with mandatory filing norms reached to 82% in 2018 in comparison to 60% filing early years.[23] Around 1,00,000 directors were disqualified in relating to such companies and directors of many such companies filed petitions in different High Courts.[24] Mandatory self-assessment test has been imposed for independent directors by the government for improving the knowledge base of independent directors.[25]

Shareholder engagement has been low in listed companies. The facility of e-voting at general meetings has promised to improve the voting ratio by participation of more shareholders in decision-making.[26] Annual general meetings and extraordinary meetings of companies are held through physical mode in Indian listed companies. In view of COVID-19, annual general meetings and extraordinary general meetings were allowed to be held virtually through video-conferencing or other audio-visual mode through notifications in April 2020.

The FDI Policy, 2017 was also revised for curbing opportunistic takeovers and acquisitions in Indian companies in view of unpredictable circumstances arising out

[20] Rajat Arora, 'Ministry of corporate affairs deregisters 50,000 shell companies in a week' *The Economic Times* (New Delhi, 11 August 2018) https://economictimes.indiatimes.com/news/economy/policy/ministry-of-corporate-affairs-deregisters-50000-shell-companies-in-a-week/articleshow/65361314.cms?from=mdr accessed on 18 April 2020.

[21] Shell companies after demonetization, Response to the Unstarred question no. 359, answered on Tuesday, the 06th February, 2018 in Rajya Sabha, Ministry of corporate affairs, Government of India, http://www.mca.gov.in/Ministry/pdf/ru359_07022018.pdf available on www.mca.gov.in accessed on 18 April 2020.

[22] This has to be read along with the provision relating to dormant companies under the Companies Act, 2013, s. 455.

[23] 'After MCA drive to strike off shell cos, compliance with mandatory filing norms climbs to 82%' *The Indian Express* (New Delhi, 14 March 2020) https://indianexpress.com/article/business/companies/after-mca-drive-to-strike-off-shell-cos-compliance-with-mandatory-filing-norms-climbs-to-82-6313414 accessed on 27 April 2020.

[24] A director in a company that has not filed financial statements or annual returns for three years in a row will not be eligible for re-appointment as a director in that or any other company for five years under CA, 2013, s 164(2).

[25] IICA under Section 150(1) of the Companies Act, 2013 will conduct Online Proficiency Self-Assessment. IICA by complying with Rule 6(1) of the Companies (Appointment and Qualification of Directors) Rules, 2014 will conduct the test through Independent Director's Databank. https://www.independentdirectorsdatabank.in/self_assessment.

[26] Rule 20, Companies (Management and Administration) Rules, 2014; S. 108, CA, 2013 available at http://ebook.mca.gov.in/Actpagedisplay.aspx?PAGENAME=18036.

of COVID-19.[27] Under 3.1.1.(a) an entity of a country, which shares land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country, can invest only under the Government route. In the event of the transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within the restriction/purview of the par 3.1.1(a), such subsequent change in beneficial ownership will also require Government approval.[28]

The SEBI has been bringing new and revising old regulations to improve corporate governance.[29] It has recently brought the stewardship code for mutual funds and alternate investment funds for enhancing their responsibilities as institutional investors.[30] Proxy advisory firms which have also been playing important role as intermediaries in shareholder engagement have also been now regulated by SEBI through SEBI (Research Analysts) Regulations and a set of Procedural guidelines.[31]

The consistent efforts by the MCA and SEBI is improving disclosures and compliances by companies. Multifarious issues challenging corporate governance have arisen and regulatory changes have been brought accordingly to deal with them by the regulators and the law.

Prof. (Dr.) Harpreet Kaur
Professor of Law

[27]Between January and March 2020, the People's Bank of China purchased shares in HDFC Bank, The Chinese Central Bank has bought 1,74,92,909 crore (174.92909 trillion) shares, or 1.01 percent of the shareholding 'People's Bank of China picks up 1.75 crore shares in HDFC' (*Money Control*, 12 April 2020) https://www.moneycontrol.com/news/business/peoples-bank-of-china-picks-up-1-75-crore-shares-in-hdfc-5135931.html?fbclid=IwAR1ctrPnoRpBfmphgpm44qNTwnqzMECmXhoZaCOPsCtb5XJBjgZNmo1uMa8 accessed on 12 April 2010.

[28]Department for Promotion of Industry and Internal Trade, Ministry of Commerce & Industry, Government of India, 'Review of Foreign Direct Investment (FDI) policy for curbing opportunistic takeovers/acquisitions of Indian companies due to the current COVID-19 pandemic' (17 April 2020) https://dipp.gov.in/sites/default/files/pn3_2020.pdf accessed on 19 April 2020

[29]https://www.sebi.gov.in/sebiweb/home/HomeAction.do?doListing=yes&sid=1&ssid=3&smid=0.

[30]https://www.sebi.gov.in/legal/circulars/dec-2019/stewardship-code-for-all-mutual-funds-and-all-categories-of-aifs-in-relation-to-their-investment-in-listed-equities_45451.html.

[31]https://www.sebi.gov.in/legal/regulations/sep-2014/securities-and-exchange-board-of-india-research-analysts-regulations-2014-last-amended-on-april-17-2020-_34615.html.

Contents

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Prof. (Dr.) Harpreet Kaur is a Professor of Law at National Law University, Delhi. She is also the Director of the Center for Corporate Law and Governance at the university. She teaches Corporate Law, Securities Regulations and Competition Law. She is a Fulbright Scholar in Residence and US State sponsored International Visitor Leadership Programme Fellow. She has served as Indian Council for Cultural Relations Chair Professor of Indian Studies at Leibniz University, Hannover, Germany from October 2015 to April 2016. She is a Visiting Professor at Faculty of Law, University of Bergen, Norway. She has many books in co-authorship with Dr. Avtar Singh and international paper publications to her credit.

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Part I
Corporate Governance

Chapter 1
Shareholders' Engagement and Sustainability of Companies

Harpreet Kaur

Abstract Shareholders' engagement in companies is a prerequisite for good corporate governance. Accordingly, company laws across all jurisdictions contain provisions to ensure such fundamental requirement and take measures for improving shareholders' engagement with the companies in which they are shareholders. The Council for European Union felt the need to review the Shareholders' Rights Directive (2007/36/EC) after the financial crisis due to deficient standards of corporate governance observed in companies. The Council is of the opinion that to ensure long term sustainability of companies, shareholder engagement needs to be strengthened. The present chapter discusses five major issues reviewed by the Council and provides Indian position on such issues. The chapter has been converted from the key note speech that was delivered in 9th International Conference on Corporate Governance, Fraud, Ethics and Social Responsibility.

Keywords Beneficial ownership · Corporate governance · Institutional investors · Related party transactions · Shareholders' Rights Directive · Shareholder engagement · Sustainability

Shareholders' engagement in companies is a prerequisite for good corporate governance. Accordingly, company laws across all jurisdictions contain provisions to ensure such fundamental requirement and take measures for improving shareholders' engagement with the companies in which they are shareholders. The Council for European Union felt the need to review the Shareholders' Rights Directive (2007/36/EC) after the financial crisis due to deficient standards to corporate governance observed in companies.[1] The Council is of the opinion that to ensure long term sustainability of companies, shareholders' engagement needs to be strengthened. In its Action Plan, 2012 relating to European company law and corporate governance,

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32007L0036.

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the Commission announced a number of actions in the area of corporate governance, particularly to encourage long-term shareholder engagement and to enhance transparency between companies and investors.

The Shareholders' Rights Directive (2007/36/EC) is also referred as SRD I and its revision is referred as SRD II (2017/828). The Council felt that deficiency in the corporate governance norms followed by companies has resulted in the financial crisis. Therefore, in order to contribute to the long-term sustainability of the companies it found necessary to review the engagement of shareholders in listed companies. Such review was conducted to remove deficiencies and obstacles in the long-term engagement of shareholders with the company and in turn, to promote more transparency about their role in the decision making. The Directive has established specific requirements which will apply to identification of shareholders and exercise of their rights, remuneration of directors, transmission of information, transparency for institutional investors and related party transactions.

In comparison to European companies, Indian companies are generally promoter-driven and controlled companies irrespective of the shareholding of promoters in companies.[2] It is an accepted fact that the pattern of ownership and control determines the level of corporate governance in companies. India witnessed issues relating to remuneration of directors, key managerial personnel in companies, influence of promoters and decisions on buy-backs of shares etc. in a few major companies. Involvement of institutional investors in the decision making of companies has also been raised due to their short-termism in companies.[3] In buy-backs, IT companies have shelled out millions of dollars which raised questions about the long-term viability on the grounds of promoter participation and expansion by the companies along with the gain to group entities.[4] All such issues point towards sustainability of companies. Important companies like Infosys, companies under Tata group[5] and

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[2]Promoter is defined by s. 2(69), Companies Act, 2013. Promoters' shareholding also includes shareholding of promoter-groups. Promoter and promoter-group is defined respectively by the Regulation 2(1) (oo) and (pp) SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018; See Avtar Singh, Company Law, 17th edition, EBC, 2018 for understanding the importance of promoters in companies, pp 135–137.

[3]Jesse Fried, *Short-Termism and Shareholder Payouts: Getting Corporate Capital Flows Right*, Harvard Law School Forum on Corporate Governance and Financial Regulation, Jan. 12, 2017.

[4]Maghna Mandavia, *TCS: Tata Sons pockets over Rs. 10,000 crore from TCS buyback*, The Economic Times, June 8, 2017 available at https://economictimes.indiatimes.com/markets/stocks/news/tata-sons-pockets-over-rs-10000-crore-from-tcs-buyback/articleshow/59039417.cms.

Infosys fixes November 1 as record date for Rs. 13,000 crore buyback, Oct 9, 2017 available at https://economictimes.indiatimes.com/markets/stocks/news/infosys-fixes-november-1-as-record-date-for-rs-13000-crore-buyback/articleshow/61010777.cms.

[5]Dnyanesh Jathar and Maijo Abraham, *Why was Cyrus Mistry ousted as Tata Sons chairman in 2016?* The Week, Dec 18, 2019 available at https://www.theweek.in/news/biz-tech/2019/12/18/replug-why-was-cyrus-mistry-ousted-as-tata-sons-chairman-2016.html.

start-ups like Flipkart[6] have faced multiple issues. Such issues in Infosys had led to resignation by the chief executive officer of the company.[7]

The Indian Companies Act, 2013 brought in new provisions for improving corporate governance in companies with more powers in the hands of shareholders. It focused on role, appointment, remuneration, duty and accountability of directors, related party transactions, disclosures and investor protection. It added to shareholders' democracy and freedom through rights for class action suits and exit opportunities. However, the sustainability of companies is an issue relevant for Indian jurisdiction too and same effort as put up by the European Council for better regulating shareholders' engagement is imperative for Indian jurisdiction. Therefore, the author felt the need to study and draw some conclusions for Indian jurisdiction. The present chapter discusses five major issues reviewed by the Council and provides Indian position on such issues.

1. **Identification of Shareholders**—Article 3a of the Directive provides companies the right to identify their shareholders by collecting their information so as to enable direct communication with them. Companies are empowered to store this data so long as a person remains a shareholder.[8] The Directive in Article 3c encourages long-term shareholder engagement, provides for identification of shareholders in order to exercise shareholder rights, to establish direct communication with the actual shareholder and to improve transmission of information along the chain of intermediaries and to protect the rights of the beneficial owner by providing that the intermediary make arrangements for the shareholder to exercise their rights to participate and vote.

In India, the Companies Act, 2013 included a provision whereby the declaration of beneficial interest in a share is required to be given by both the legal owner and the person holding beneficial interest in the share.[9] The company records such information in its register and files it with the Registrar of Companies. The Companies (Amendment) Act, 2017 has intended to unravel *benami* holdings in a company and amended S. 90 of the Act.[10]

S. 90 (1) of the Companies Act, 2013 provides that every individual, who acting alone or together, or through one or more persons or trust, including a trust and persons resident outside India, holds beneficial interests, of not less than 25% or such other prescribed percentage, in shares of a company or the right to exercise, or the actual exercising of significant influence or control as defined in clause (27) of section 2, over the company (herein referred to as 'significant beneficial owner'), shall make a declaration to the company, specifying the nature of his interest and other

[6]Alisha Singhal, *Flipkart and Snapdeal merger: What does the future hold?* available at https://qrius.com/flipkart-snapdeal-merger-future-hold/.

[7]*Five reasons why CEO Vishal Sikka had to leave Infosys*, ET Online, Aug 18, 2017 available at https://economictimes.indiatimes.com/tech/ites/five-reasons-why-ceo-vishal-sikka-had-to-leave-infosys/articleshow/60114080.cms?from=mdr.

[8]Lee Roach, *The Amended Shareholders' Rights Directive*, May 28, 2017, available at https://companylawandgovernance.com/2017/05/28/the-amended-shareholder-rights-directive/.

[9]S.89, Companies Act, 2013.

[10]Two different persons hold the legal ownership and beneficial interest in the shares.

particulars, in the prescribed manner and within the prescribed period of acquisition of the beneficial interest or rights and any change thereof.[11]

The Companies (Significant Beneficial Owners) Rules, 2018 has defined who is a 'significant beneficial owner'. It means an individual referred to in section 90 (1) (holding ultimate beneficial interest of not less than 10%) read with sub-section (10) of section 89, but whose name is not entered in the register of members of a company as the holder of such shares, and the term 'significant beneficial ownership' shall be construed accordingly.

The Indian law is trying to decode and clear out *benami* holdings in companies and ensure that complex structures of group companies with cross-shareholdings and chains of companies are not used to hide the real owner of securities. The purpose is to declare the influence and nature of interest of the significant beneficial owners and penalise hidden transactions of beneficial ownership. However, no protection of the rights of beneficial owner is provided.

It is interesting to make a comparison between the provisions of the Directive and the Companies Act, 2013 regarding identification of shareholders. Under the Directive, companies have the discretion to require information on beneficial ownerships (Article 3a). If such information is requested, the intermediaries are required to transmit the necessary information under Article 3b (4). It is not necessary to send such information to all shareholders as per Article 3b (3). Member States are directed to establish framework where transmission between several intermediaries is efficient (Article 3b).[12] Under the Indian position, declaration of beneficial interest is mandatory under section 89(1). Every company must mandatorily maintain a register containing information on beneficial interest. Information of beneficial owner is open to inspection by any member of the company under Section 90(3). Declaration must be made within 90 days and is stored in the register.[13]

2. **Institutional Investor Engagement**—Newly added Article 3g on the engagement policy in the Directive provides that the institutional investors and asset managers comply with two requirements. Firstly, they are required to develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement into their investment strategy. Secondly, they have to publicly disclose how their engagement policy has been implemented. Therefore, the institutional investors, equipped with the knowledge and expertise, are expected to play an important role in the corporate governance. Article 3h provides for institutional investors to publicly disclose how the main elements of their equity investment strategy are consistent with the profile and duration of their liabilities.

India has not seen high levels of shareholder engagement. The Securities and Exchange Board of India (SEBI) has also pushed for greater participation by asset

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[11] Clause 22 of the Companies (Amendment) Act, 2017 replaced s. 90.

[12] It is advised to read EU Directive on Money Laundering also. The Directive is available at https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/anti-money-laundering-and-counter-terrorist-financing_en.

[13] Rules 3 and 5, The Companies (Significant Beneficial Owners) Rules, 2018, available at https://www.mca.gov.in/Ministry/pdf/CompaniesSignificantBeneficial1306_14062018.pdf.

management companies by mandating disclosure of their voting records.[14] SEBI in 2010 had set out rules for asset management firms to vote in company resolutions and disclose their policies to exercise such votes. This effort was successful by reducing mutual funds' abstention from voting on shareholder resolutions from 80% to 10%.[15] Despite the positive impact, it has been said that such rules fall short of a full set of principles. There is a need to adopt a comprehensive policy to address participation by the institutional investors.[16]

In 2017, there was a resurgence of greater involvement of institutional investors. Noticing the poor track record of insurance companies, who form the largest domestic institutional investors, Insurance Regulatory Development Authority of India (IRDAI) drafted a common stewardship code with several guidelines ranging from voting policy to intervention by investors in companies.[17]

SEBI through the Kotak Committee agreed that a common stewardship code for institutional investors should be introduced for the financial sector on the lines of best practices globally. SEBI agreed with the recommendation but had reservations that prescribing a rule-based approach for all activities would lead to the micro-management of the company.[18] In June 14, 2018, the Financial Stability and Development Council had set up a sub-committee where they discussed issues relating to common stewardship code.[19]

The stewardship code implemented by the SEBI provides for the following:[20]

(Principle 1)

Institutional Investors should formulate a comprehensive policy on the discharge of their stewardship responsibilities, publicly disclose it, review and update it periodically.

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[14]Circular for Mutual Funds, SEBI/IMD/CIR No 18/198647/2010 (Mar. 15, 2010) and Master Circular on Mutual Funds, SEBI/IMD/MC No. 3/10554/2012 May 11, 2012.

[15]Institutional investor advisory services, "Stewardship Code for India – IRDA intensifies the agenda" Mar 24 2017 https://docs.wixstatic.com/ugd/91c61f_b117c052c5ba4541b104f3569e3ae352.pdf.

[16]Livemint "India to draft rules for institutional investors voting on company matters" (Mar 06 2017) https://www.livemint.com/Companies/0teJ9go8GQPOOrxuAadTeJ/India-to-draft-rules-for-institutional-investors-voting-on-c.html.

[17]Circular: PFRDA/2018/01/PF/01 "Common Stewardship Code" (May 4 2018) http://www.pfrda.org.in/WriteReadData/Links/Circular-%20Common%20Stewardship%20Code%2004-05-186ec9a3b4-566b-4881-b879-c5bf0b9e448a.pdf.

[18]SEBI, View on the Recommendations of Kotak Committee on Corporate Governance (Annexure B, 67) https://www.sebi.gov.in/sebi_data/meetingfiles/apr-2018/1524031522572_1.pdf.

[19]21st Meeting of the FSDC Sub-Committee, 2017-2018/3276 (June 14, 2018) https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=44208.

[20]Stewardship Code for all Mutual Funds and all categories of AIFs, in relation to their investment in listed equities, Dec 24, 2019, Circular No.: CIR/CFD/CMD1/168/2019. The implementation date of the code was extended to July 1, 2020 from April 1, 2020 due to the covid-19.

(Principle 2)

Institutional investors should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.

(Principle 3)

Institutional investors should monitor their investee companies.

(Principle 4)

Institutional investors should have a clear policy on intervention in their investee companies. Institutional investors should also have a clear policy for collaboration with other institutional investors where required, to preserve the interests of the ultimate investors, which should be disclosed.

(Principle 5)

Institutional investors should have a clear policy on voting and disclosure of voting activity.

(Principle 6)

Institutional investors should report periodically on their stewardship activities.

It is important to highlight that the Directive only provides for a bilateral monitoring relationship between institutional investors and asset managers, but not with investee companies. It does not provide for intervention by institutional investors. However, it requires institutional investors to publicly disclose how their investment strategy is consistent with their long-term liability. In Indian code, no provision for long-term stewardship of assets is observed. The principles do not consider reducing short-termism and its detrimental effect on long-term financial performance leading to sub-optional level of investments.

3. **Transparency by Proxy Advisors**—The Directive has mandated public disclosure of the code of conduct of proxy advisory firms.[21] India is one of the very first jurisdictions to regulate the working of such firms. SEBI has issued detailed guidelines on the functioning of such proxy advisory firms, including certification and management of conflicts of interest.[22] Few anecdotal evidences are shared as recent examples of recommendations of proxy advisory firms in India. Recommendations of proxy advisory firms in voting against proposals by Akzo Nobel India and Escorts Ltd. to merge unlisted group entities with the parent and those relating to transfer of Raymond's property to promoters at throwaway prices,[23] and suggesting

[21] Art. 3j, EU Directive 2017/828.

[22] SEBI (Investment Advisers) Regulations, 2013.

[23] Patha Sinhal, *Singhanias eye 7kcr JK House for just 600cr*, The Times of India, May 26, 2017, available at http://timesofindia.indiatimes.com/business/india-business/singhanias-eye-7kcr-jk-house-for-just-600cr/articleshow/58850146.cms; Daniels v. Daniels, (1978) 2 All ER 89.

shareholders of Infosys to vote against the re-appointment of its auditors show that they will a have greater role to play in corporate governance.[24]

4. **Right to Vote on Remuneration**—The Directive obligates companies to formulate a remuneration policy and issue a remuneration report to be displayed on website for a period of ten years. It also gives shareholders the right to vote on the remuneration policy.[25] Member States may allow companies, in exceptional circumstances, to temporarily derogate from the remuneration policy, provided that the policy includes the procedural conditions under which the derogation can be applied and specifies the element of the policy from which derogation is possible. In India, the Companies Act provides for a maximum cap on the remuneration payable to directors, including managing director, whole-time director and managers as eleven percent of the net profits in that financial year.[26] The remuneration is recommended by the Nomination and Remuneration Committee, on the principle of balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals.[27] There have been recent cases in India whereby executive compensation has been questioned. This calls for a change in the existing law insofar as transparency regarding executive compensation is concerned.

The biggest difference with respect to the amended Directive and the Companies Act, 2013 on remuneration related provisions is that under the Directive the shareholders are entitled to vote on the remuneration policy. The Member States may either provide for that vote to be binding or advisory. Any derogations from such policy would only be permissible in consonance with exceptions laid out in such a policy itself. Any amendments to this policy are also subject to be re-voted by the shareholders, and the policy is required to be brought up for consideration after four years in any event. The Companies Act, 2013 does not provide for such expansive powers to the shareholders. Section 197 requires approval of the company in general meeting by passing a special resolution for remuneration that exceeds threshold as provided by the section. Subsection (4) lays down that the remuneration must be determined under the section either by the articles themselves, or by a special resolution, or if the articles have a provision requiring the agreement of the shareholders, then such approval must be sought by a special resolution.

The Directive very comprehensively lays down the guidelines for the framing of a remuneration policy, and includes provisions on what the substantive content of such a policy has to contain. Along with this, the Directive also requires that such a policy must explain, within it, the reasoning behind the provisions adopted therein. There is also a provision mandating that Member States must ensure publishing of such remuneration policies, along with a remuneration report to be drawn up detailing the

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[24]Bhuma Srivastava, *Proxy advisory firms give a boost to shareholder activism*, Livemint, June 29, 2012, available at http://www.livemint.com/Companies/HeuG8SPSw3zXE4sUYhecqN/Proxy-advisory-firms-give-a-boost-to-shareholder-activism.html.

[25]Art.9a, EU Directive 2017/828.

[26]S. 197, Companies Act, 2013.

[27]178, Companies Act, 2013.

remuneration awarded in the most recent financial year. In the Companies Act 2013, section 197(12) requires listed companies to disclose in their board reports the ratio of the remuneration of the director of a company to its median employee.

The Companies Act, 2013 is thus, lagging behind on shareholder rights with respect to the right to vote on matters relating to remuneration policies. In fact, such rights are non-existent within the Act. The EU directive, on the other hand, provides for extensive rights to shareholders and mandates that companies draft a comprehensive remuneration policy in order to avoid any unfair compensation to the directors.

5. **Related Party Transactions (RPTs)**—The Amendment of the Directive provides for Member States to define what a 'material transaction' is. The companies that enter into material transactions with related parties must publicly announce the transaction at the latest at the time the transaction is concluded, and provide specified information relating to the transaction.[28] Member States shall ensure that material transactions with related parties are approved at the general meeting. The Companies Act, 2013 provides for approval of related-party transactions by the Board of Directors, but with the approval of the company, in case the prescribed thresholds of paid-up share capital or transaction value are met.[29] The interested member should not vote at such a meeting. However, such restriction does not apply to a company in which 90% or more members, in number, are relatives of promoters or are related parties.[30] However, there is an exemption given in S. 188 under which such requirements do not apply to transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis. The term 'related parties' have also been defined by the Act.[31]

Under the revised Clause 49 of the SEBI-Listing Agreement, there was a requirement that an audit committee consisting of three board members must review all related party transactions.[32] In the case of material related party transactions, prior approval of the Audit Committee was required.[33] Revised Clause 49 of the SEBI Listing Agreement provided some additional disclosures required for listed companies. Details of all material related party transactions were required to be disclosed along with compliance report on corporate governance. The companies were mandated to disclose the Related Party Transactions on their website.[34] The listing agreement is now dealt by the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

[28] Art. 9c, EU Directive 2017/828.

[29] Section 188, Companies Act 2013.

[30] Proviso added in S. 188 by the Companies (Amendment) Act, 2017.

[31] 2(76), Companies Act, 2013.

[32] Clause 49(III), SEBI Listing Agreement; Listing agreement requirements are now covered by the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. Therefore, this information is shared to provide readers the earlier regulation.

[33] Clause 49(VII), SEBI Listing Agreement.

[34] Clause 49(VIII), SEBI Listing Agreement.

The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 provide for a duty of board of directors to monitor and manage potential conflicts of interest of management, members of the board of directors and shareholders, including misuse of corporate assets and abuse in related party transactions. Regulation 23 dealing with Related Party Transactions provides that the listed companies should make policies on materiality and dealings of related party transactions. A transaction is considered material if the transaction to be entered into individually or taken together with previous transactions during a financial year, exceeds ten percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity. All Related Party Transactions required approval by audit committee and omnibus approval can be given by audit committee subject to the fulfilment of conditions of the regulation 23. All material related party transactions require approval of the shareholders through resolution and the related parties are mandated to abstain from voting on such resolutions whether the entity is a related party to the particular transaction or not. However, exemptions are given if such transactions are between two government companies or between a holding company with its wholly owned subsidiary company. The regulation further provides that for the purpose of this regulation, all entities falling under the definition of related parties shall abstain from voting irrespective of whether the entity is a party to the particular transaction or not.

There are some key differences between the Directive and the provisions of the Companies Act dealing with Related Party Transactions. In the scheme of the Companies Act, it is only required that the contract or arrangement entered into under s. 188 will be referred to in the Board report to the shareholders along with the justification. In case any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a resolution in the general meeting and if it is not ratified by the Board or by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, such contract or arrangement becomes voidable at the option of the Board or of the shareholders. If the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned are required to indemnify the company against any loss incurred by it.

The Directive mandates that Related Party Transactions must be announced by companies latest by the time of the conclusion of the transaction. It also includes the information that such an announcement must necessarily contain.[35] The Directive also includes a provision allowing Member States to require that a report should be independently prepared assessing whether the transaction is fair and reasonable. This report must be prepared by either an independent third party, the administrative or supervisory body of the company, or the audit committee (comprising majorly of independent directors).[36] The Directive provides Member States with an option to make shareholder approval necessary for RPTs.[37] Similar to the Indian position,

[35]Directive (EU) 2017/828, Art. 9(c), 2.

[36]Directive (EU) 2017/828, Art. 9(c), 3.

[37]Directive (EU) 2017/828, Art. 9(c), 4.

transactions entered into in the ordinary course of business and concluded on normal business terms are exempt from the regulations. The Directive does require that they be internally reviewed by the administrative or supervisory body of the company.[38]

Thus, the position of the Directive and the Indian law on Related Parties Transactions is similar, except that the Directive allows for more power to shareholders (by not subjecting their approval to thresholds). The disclosure requirements are also more or less in conformity. The provision of an independent report on the fairness of the Related Party Transaction is an added benefit of the Directive and perhaps something we could consider introducing in Indian Law.

Other than the above-mentioned provisions, there are certain other provisions in Companies Act to increase the participation by minority shareholders-class-action suits against the company,[39] its directors, auditors for mismanagement and acting against the interests of members and depositors,[40] appointment of small-shareholders' director etc.[41] The discussion above indicates that provisions under the Companies Act are almost on the same lines as the Directive. However, an empirical study of the shareholders' engagement is required to provide an evidence for real effect of such provisions. It is necessary that decisions should be taken by a company or its Board keeping in mind the long-term benefit and sustenance of the company. It is necessary for sustainability of any company that its shareholders participate in decision making and take informed decisions. With respect to the corporate scenario in India, it must be noted that the existence of promoters and the cross holding of promoters across group entities tends to concentrate ownership in a few hands. Therefore, any measure or proposed amendment should be mindful of this change.

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[38]Directive (EU) 2017/828, Art. 9(c), 5.

[39]245, Companies Act, 2013; National Company Law Tribunal Rules, 2016.

[40]Satya Charan Lal v. Rameshwar Prasad Bajoria, AIR 1950 FC 133 (Federal High Court decision).

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Chapter 2
Corporate Governance Failures as a Cause of Increasing Corporate Frauds in India—An Analysis

Vijay Kumar Singh

Abstract One has witnessed a rise in corporate governance failures over the past few years with cases of *Vijay Mallaya*, *Nirav Modi* and likes. Recent addition to the typology of corporate frauds are the insolvency related frauds, for e.g. the recent issue of *Jaypee's* mortgage is alleged to be done fraudulently. Everyone in the corporate circle received a shock on hearing the *Chanda Kochhar's* case of alleged non-compliance of corporate governance norms. While this paper was being written, we saw another major corporate governance failure leading to the *IL&FS crisis,* requiring the government to step in like *Satyam*. Corporate Governance norms have been formalised in India through specific provisions in the Companies Act, 2013 incorporating provisions relating to corporate frauds. The clause 49 of the Listing Agreement is now given a statutory by way of Listing Regulations of SEBI (LODR). At times, the corporations have not liked this tight scrutiny by the regulator and accordingly some compliances were relaxed for private companies in the Companies Act, 2013. One of the major factors which played a significant role in controlling corporate frauds was having a robust internal control mechanism and its regular testing. However, a survey by *Grand Thornton* in 2014 indicated that fraud risk assessment and compliance controls review was seen as a one-time exercise by most corporates and not taken that seriously subsequently. The present paper would explore whether the efforts taken under the Companies Act, 2013 and SEBI Regulations have served its purpose in decreasing the corporate frauds in India. Recently, the Government has notified the constitution of National Financial Reporting Authority (NFRA); this paper would also examine as to how NFRA would contribute in regulating the corporate frauds. Through some examples it would be explored whether the corporate governance failures are the cause for increasing corporate frauds in India.

Keywords Corporate governance · Corporate fraud · Banking fraud

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Just as it is impossible to know when a swimming fish will drink water, so it is impossible to find out when a corporate steward is stealing money.

Kautilya's Arthashastra-300 B.C. (as cited in Ponduri et al. 2014)

Corporate governance deals with key questions of what mechanism would ensure fair and proper utilisation of capital contributed especially by the faceless and powerless small investors (Securities and Exchange Board of India [SEBI] 2017). A good corporate governance ensures trust of investors in the company ultimately leading to better returns (Agrawal and Knoeber 2012). On the contrary, a loose corporate governance framework leads to opportunities of corporate frauds, distrust and low investor confidence, which is not only detrimental to the concerned corporation, but to the market as a whole. Damage to the organisation's brand and market reputation is the greatest cost of fraud other than the financial loss, legal costs, and cost for remedial measures (Grand Thornton 2014).

From a securities market perspective, corporate frauds transgresses the '*right in personam*' boundary and it becomes a 'public policy' issue (N. Narayanan v. SEBI 2013), especially involving public companies wherein there are large number of shareholders and a fraud-hit tumbles the stock market. The losses are multifaceted in short and long term. Loss to the shareholders were pegged at Rs. 14,000 crores ($140 billion) in the *Satyam Scam* other than dampening of market sentiments and spiralling/chilling effect on the overall stock market. The Uday Kotak Report on Corporate Governance (SEBI 2017) recognises that "several corporate governance failures across the world and an increasingly complex regulatory environment have sharpened the focus on good governance". Tightening of corporate governance levers have been necessitated in view of the evolving complex corporate processes to hide fraudulent behavior.

2.1 Corporate Governance and Frauds

As propounded by the famous criminologist, *Donald R. Cressey*, the Fraud Triangle involves the following three key elements which leads to the fraud, i.e. (i) Pressure/Incentive (ii) Opportunity and (iii) Rationalisation/Justification (Deloittee and FICCI 2013). In a corporate setting, the second element, i.e. opportunity is provided by the corporate governance failures, in terms of not having proper internal controls or checks and balances. While pressure of performance is understandable, incentive is offered by a weak corporate governance framework. Rationalisation/justification of a fraud is an ethical issue which again emanates from the corporate governance culture set over the years, wherein a small or minor defaults/misdemeanour is discounted for being "okay" or "*chalta hai*" in Indian colloquial terms.

In the context of 2008 financial crisis, some authors argue that the crisis was due to systemic failure of corporate governance (William et al. 2012). "The systemic failure of corporate governance is particularly associated with the Anglo-American corporate governance model that has enabled, permitted or tolerated excess power and wealth at the hands of CEOs and cultivated a 'greed-is-good' culture in banks" (William et al. 2012). Every corporation has distinctive characteristics and an ethos of its own, which is used to determine, as a precondition for imposing liability, whether the organisation encouraged its employees or its agents to perform the delinquencies (Fisse and Braithwaite 1993). CEO plays a central role in perpetrating a culture of opportunity to commit fraud. "CEO connections with other top executives and directors could increase or decrease the incidence of corporate fraud. As with other corporate activities, corporate wrongdoing often requires coordination between, or acquiescence by, top executives and/or board members" (Khanna et al. 2015).

'Fraud' as a term in India has been traditionally dealt with in two legislations, i.e. the Indian Penal Code (IPC) and the Indian Contract Act. Sections 421–424 of IPC deals with Fraud and Sections 415–420 deals with cheating. As per section 25 of IPC, "a person is said to do a thing fraudulently if he does that thing with intent to defraud but not otherwise" making *mens rea* an important ingredient. Section 17 of the Indian Contract Act, 1872 defines 'fraud' which includes making of a suggestion as a fact which is not true or active concealment of a fact which one has a knowledge about or a promise made without any intention of performing it, including silence, with an intent to deceive another party thereto or his agent, or to induce him to enter into the contract.

As may be analyzed from the definition, while the former deals with criminal law violation requiring '*mens rea*' and is prosecuted '*in rem*', the later is under law of obligations and is governed by privity of contract. However, a fraud under later may segway into a criminal violation under IPC. In the Iridium Case (2011), issue was whether the company can commit *mens rea* offences like cheating and conspiracy under IPC; Supreme Court reiterating the principles laid down in Standard Chartered (2005) drew a clear distinction between the 'fraudulent and dishonest' misstatements of the issuer company in the İnformation Memorandum and a case of bad business judgment. Thus, the companies in India can be prosecuted for the offences under IPC (other than offences like rape and murder, which necessarily requires a human subject for prosecution), including frauds and cheating.

It may further be noted that prosecution under the IPC comes within the domain of the State Governments in India. *JJ Irani Committee* (2005) while recommending for establishment of Serious Fraud Investigation Office (SFIO) had observed that "it may not be easy for the law enforcement agencies at the State Government level to respond effectively to such situations in the absence of proper training and development of skills of the concerned law enforcing personnel for such investigations" (cited in Singh 2017). Accordingly, at the Central Level, now there is SFIO to deal with 'corporate frauds' under the Company Law. However, this does not grant exclusivity to SFIO in dealing the cases of fraud, as instances falling under IPC (criminal law) shall be still maintainable.

Several committees on corporate governance, like *Naresh Chandra Committee on Corporate Governance* (2003), have recommended for a focused attention on developing mechanism to deal with 'corporate frauds'. Companies Act, 2013 (CA 2013) came after the infamous *Satyam Scandal* (2009) and *Sahara case*, which actually triggered a spate of corporate governance reforms into the company law; for example, statutory duty on auditors and to other professionals to report frauds to Central Government (Section 143 (12) of CA 2013), mandatory rotation of auditors, etc. The Parliamentary Committee examining the Companies Bill 2009 stated that fraudulent conduct/practices must be dealt severely and decisively with deterrent provisions including imprisonment prescribed to pre-empt fraudulent conduct/practices; however, technical or procedural mistakes or delays may be considered in broader perspective and bonafide managerial conduct/decisions to be protected (Ministry of Corporate Affairs [MCA] 2010).

2.2 Definition and Punishment of 'Corporate Fraud'

Section 447 of the CA 2013 defines "fraud" in relation to affairs of a company or any body corporate, and includes (a) any act, (b) omission, (c) concealment of any fact or (d) abuse of position, committed by any person or persons in connivance, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain (means the gain by unlawful means of property to which the person gaining is not legally entitled) or wrongful loss (means the loss by unlawful means of property to which the person losing is legally entitled). Any person found guilty of fraud shall be punishable with a term of imprisonment not less than 6 months but which may extend to 10 years and shall also be liable to fine which shall not be less than the amount involved in fraud but which may extend to 3 times the amount involved. In cases involving public interest, the term of imprisonment shall not be less than 3 years. The term 'public interest' has not been defined and it has been held that "public interest" does not have a rigid meaning, it is elastic and takes its colour from statute in which it occurs (BPSC v. SHA Rizvi 2012). Thus it may be noted that the provisions of corporate fraud goes beyond professional liability, extending even to personal liability. It may be noted that the aforesaid punishment is in addition to any other liability arising out of the fraudulent conduct, say for e.g. disgorgement of profits.

The aforesaid provisions were quite stringent and necessitated an observation from the Company Law Review Committee (MCA 2016) leading to the changes in the provisions on the ground that very stringent provisions would lead to a chilling effect in getting good talent and in certain cases the cost of prosecution may exceed the quantum involved. As per changed law, now the amount involved must be at least 10 lakh rupees or one percent of the turnover of the company whichever is lower and in cases where the amount involved is less than the aforesaid amount the punishment is limited to five years or with fine which may extend to 20 lakh rupees or with both (Companies Amendment Act, 2017 w.e.f. 03.01.2018). The following statement of the Committee is worth noting:

> The Committee received suggestions that the ambit of Section 447 was too broad and would result in minor infractions being punished with severe penalties, which are non-compoundable. However, it was also suggested during the discussions that once the offence

of fraud is established, it would not be tenable to provide for a threshold for it to be punishable under Section 447. The Committee observed that the provision has a potential of being misused and may also have a negative impact on attracting professionals in the post of directors etc. and, therefore, recommends that only frauds, which involve at least an amount of rupees ten lakh or one percent of the turnover of the company, whichever is lower, may be punishable under Section 447 (and non-compoundable). Frauds below the limits, which do not involve public interest, may be given a differential treatment and compoundable since the cost of prosecution may exceed the quantum involved (MCA 2016).

A recent report of MCA recommended to bring defaults related to certain corporate governance norms under the in-house adjudication mechanism of the Ministry (i.e. Regional Directors) which would involve levying penalties in case of defaults (MCA 2018). Some of these defaults are in the nature of prohibition on issue of shares on discount section 55(3); accepting directorship beyond specified limit—section 165(6); payment to director not to be made in case of loss of office, except under certain circumstances and subject to prescribed limits. Any amount received by the director to be held in trust—section 191(5); overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits—section 197(15); appointment of key managerial personnel in certain classes of companies—section 203(5). This change was recommended with an objective to de-clog the formal adjudication mechanism of National Company Law Tribunal (NCLT) in view of the inherent safeguards in the law which bar the wrongdoer, and on account of easy discoverability of certain defaults on the MCA21 system, which may be rectified by imposing penalties in an in-house mechanism. This brings the aforesaid offences into the civil liability category waiving off the requirement of *mens rea*. The MCA report relies upon the principle, "a civil liability is imposed for a mere 'blameworthy conduct' and not for a crime, so presence of 'guilty intention' is a sine qua non" (Director of Enforcement v. MCTM Corporation 1996).

The aforesaid changes demonstrates that too much of a tightening of provisions may not be desirable. This also shows a pattern of response of legislators to corporate frauds as a knee-jerk reaction. A historical analysis of corporate frauds—*Harshad Mehta, Ketan Parekh, Satyam, Sahara*, etc. show a stringent response in rule making immediately after the fraud and slowly the law being relaxed on the grounds of difficulties encountered by the corporates on the commitment of strong corporate governance principles. However, after some time we see the corporate governance principles being compromised leading to a full-blown corporate fraud. We have seen several cycles of these over a period. The question is whether we have learned from our mistakes?

Serious Fraud Investigation Office (SFIO): It is a specialized agency set up by the Central Government to investigate complex corporate fraud cases. SFIO deals with the fraud cases from a multidisciplinary perspective. Section 212(6) makes the offences covered under Section 447 of the Act (Corporate Fraud) as cognizable only on an application by the Director, SFIO or any officer of the Central Government authorized, by a general or special order in writing in this behalf by the Central Government (MCA). However, it is a paradox that SFIO doesn't have powers to initiate a case on its own, in absence of any directions from the Government (Singh 2017).

2.3 Corporate Frauds and the Securities Regulator—SEBI

An efficient and fraud-free securities market is the essence of its existence. One of the primary roles of the securities regulator is to curb the fraudulent practices in the securities market. SEBI does that by way of a number of regulations like Unfair Trade Practices Regulations (2003), Insider Regulations (1992), Deposit Regulations, Intermediaries Regulations and Stock Exchange Regulations. At the core of each of these regulations lies the focus on improving corporate governance principles, be it the definition of '*fit and proper*' person or prescription on '*code of conduct*' or on '*accountability and liability*'. This is evident from the fact that stock exchanges were demutualized and corporatized over a period of time and corporate governance principles have now been moved from 'Clause 49' of the Listing Agreement to concrete Listing Regulations (2015). This change has greatly improved the corporate governance in listed entities and have contributed in checking the frauds in securities market.

It may however be noted that SEBI is still working towards betterment and the latest report on Fair Market Conduct is a testimony to that (SEBI 2018). The report examines the Unfair Trade Practice and Insider Trading Regulations and suggests measures in relation to the following:

- Market Manipulation and Fraud
- Insider Trading
- Code of Conduct under Insider Trading Regulations and
- Surveillance, Investigation and Enforcement.

2.4 Typology of Corporate Frauds

The securities scam of 1992, popularly known as the *Harshad Mehta Scam* is considered the mother of Indian Financial Scandals which provided for an immediate impetus for establishment of SEBI. SEBI primarily deals with listed companies and has been instrumental in shaping up the majority of corporate governance norms in India through its mandatory and voluntary practices for companies. However, the issue has been of the companies which fell through the cracks or grey areas between the listed and unlisted companies. The PACL Scam (Subrata Bhattacharya vs. SEBI 2017) and Sahara Case (Sahara India Real Estate Corpn. Ltd. v. SEBI 2012) (case related to jurisdictional confusion between ROC and SEBI, ruled by Supreme Court that the matter was within the domain of SEBI) could be considered as the greatest examples of these cracks. If one looks at the typologies of corporate frauds, it may be noticed that at the root of each corporate scam is a failure of the check-and-balance system which ought to be provided by strong corporate governance norms. Even in cases of private affairs (private companies), there is a requirement of some basic element of corporate governance which distinguishes it from a sole proprietorship. The 'corporate entity' offers an opportunity to the promoters to go behind the corporate veil and have limited liability; however, this veil cannot be allowed as a shield to evade liability in cases of corporate frauds (State of Rajasthan vs. Gotan Lime Stone Khanji Udyog Pvt. Ltd. 2016; State of Karnataka vs. Selvi J. Jayalalitha 2017). In the following section, we look through some of the prominent typologies of corporate frauds arising primarily due to corporate governance failures.

2.5 NSE Algo Scam or High Frequency Trading (HFT) Scam

Securities market works on the principle leveraging "price sensitive" data and information. To curb misuse of information in securities market, Insider Trading Regulations have been framed. However, the largest stock exchange of India—National Stock Exchange (NSE), which began operations with an objective to promote corporate governance principles, have been found amidst a controversy of allowing selective access to the NSE's high-speed algorithmic trading platform through its co-location service to some brokerages (NIFM n.d.). This access provided a lower time for data to travel and an unfair advantage to the concerned brokerages resulting in wrongful gain to them (Ray 2017). The case involves alleged connivance of top-ranking executives of NSE. The forensic auditor in this matter is also alleged to have been failing in its duty to highlight the concerns to which the Technical Advisory Committee (TAC) of SEBI came down heavily and recommended for an action.

It is quite interesting to note that, NSE did not budge to the allegations and to the contrary took an aggressive stand to file a Rs. 100 crore ($ 1 billion) defamation suit against one of the publishers (Moneylife) in Bombay High Court. However, Bombay High Court did not find merit in the suit and fined NSE for its overconfidence with a cost of Rs. 50 lakhs–$5 million (NSE vs. Moneywise 2015). NSE has however, withdrawn this case later. In this matter, another case has also been filed in Madras High Court seeking directions to declare the NSE Directors and KMPs as "not fit and proper", wherein notices have been issued to SEBI. This is a classic case of corporate governance failure leading to corporate frauds and further highlights the requirement of having a professionally qualified forensic team at SEBI rather than relying upon external consultants.

2.6 Financial Reporting Frauds

It has been recognized in US that financial reporting frauds are associated with weak corporate governance (Beasley 1996; Dechow et al. 1996). Generally, the financial reporting frauds are a result of "performance stress" as was in the case of *Satyam Scandal* in India which necessitated fudging of accounts to show consistent profits. Sometimes, it is because of "excessive power" (Tiscini and Donato 2006) concentrated in few hands with "dummy Boards" having very "busy directors" (Bar-Hava et al. 2013). KPMG Study (2016) shows that 44% of the perpetrators had unlimited authority in their company and are were able to override controls, even auditors and audit committees.

2.6.1 Auditors and Auditing Practices

Satyam Scam exposed the weaknesses of regulatory framework in India as well as the failure of auditors and audit firms (Singh 2013). There were 'conflict of interest' issues, complacency and failure to raise red flags. In one case, Supreme Court took cognizance of the ICAI report on "*operations of multinational network accounting firms in India*" and directed the Central Government to look into the matter through a three-member committee. Court said that "the Committee may also consider the need for an appropriate legislation on the pattern of Sarbanes Oxley Act, 2002 and Dodd Frank Wall Street Reform and Consumer Protection Act, 2010 in US or any other appropriate mechanism for oversight of profession of the auditors" (S. Sukumar vs. ICAI 2018). ICAI's role in investigating professionals registered under it have been under criticism which necessitated the constitution of an independent body named National Financial Reporting Authority (NFRA) under the Companies Act, 2013 replacing the National Advisory Committee on Accounting Standards (NACAS) under the Companies Act, 1956. NFRA will look into the cases of infarction by professionals dealing with listed companies (Section 132 of the CA 2013). It is contemplated that NFRA should be like Public Company Accounting Oversight Board (PCAOB) in USA. This is also in line with one of the IOSCO's eight principles that "auditors should be subject to adequate levels of oversight by an authority that is independent of the audit profession."

Chartered Accountants paly a very important role in keeping a check on corporate governance practices by way of their independent financial reports and observations. Their professional failure or complacency may lead to governance failure and frauds. This has also been noticed in the *T.K. Vishwanathan Committee* Report examining Unfair Trade Practices in securities market and it has been recommended that "SEBI should have clear powers to act against auditors and other third party fiduciaries with statutory duties under securities law (as defined under SEBI LODR Regulations), subject to appropriate safeguards" (SEBI 2018). However, the ICAI has expressed its dissent on the above recommendation stating that the regulation of chartered accountants is covered under the Chartered Accountants Act, 1949 and it would be better to avoid jurisdictional conflict and other issues. The aforesaid turf wars between the newly established NFRA, ICAI and SEBI may not be desirable, which may lead to situation of regulatory conflict ultimately benefiting the fraudster. We have witnessed this enough in cases like *Sahara.*

2.7 Weak Internal Controls: '*Docile*' Board of Directors

OECD identifies four weak areas in corporate governance that contributes to the financial crisis, i.e. executive remuneration, risk management, board practices and the exercise of shareholder rights. Yet, it argues that the principles of corporate governance had adequately addressed those key governance concerns and the "major failures among policy makers and corporations appear to be due to lack of implementation" of those principles (OECD 2009).

The KPMG Study (2016) finds that weak internal controls were a significant contributing factor in providing opportunity for the frauds to happen. Corruption is another dimension leading to corporate frauds. An ethical corporation which is intolerant towards corruption is more likely to have well-designed robust internal controls supplemented by a thorough risk assessments periodically which is followed by its employees and higher management.

As per Companies Act, internal financial controls means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information (Explanation to Section 134(5) of the CA 2013). CA 2013 provides for the following mechanism to provide for internal control mechanism:

- The Directors' Responsibility Statement, in case of listed companies, is required to state that it had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively (Section 134(5) of the CA 2013);
- The Auditor's Report shall also state that whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls (Section 143(3) of the CA 2013);
- Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include… (vii) evaluation of internal financial controls and risk management systems (Section 177(4) of the CA 2013);
- The independent directors shall satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible (EY 2016).

If a fraud happens even after so many safety valves; in retrospect, it may be contemplated that the valves have failed. What is needed is regular review of the systems and processes by the shareholders. However, in India we find that the shareholders are not active enough to question the Board often (Singh 2010). Response of majority of stakeholders to corporate governance failures is reactive in approach, which primarily involves exiting from the shareholding. Class action mechanism though provided in the Companies Act has not yet picked up in terms of enforcement.

2.8 'Layered Investment' and the Significant Beneficial Owner

One of the critical issues concerning the corporate sector has been un-named beneficiaries of a company or misuse of multi-layered investment through several entities. The CA 2013 puts a cap on layers of subsidiaries and requires that no investment can be made through more than two layers of investment to check on the misuse of multilayered investment through holding-subsidiary structures. This is further with an objective to help regulatory authorities to check and trace the ultimate beneficiaries in the complex corporate structures. It may be noted that the Company Law Committee (2016) had recommended for removal of the provision on the ground of being too obtrusive and impractical in modern business world; however, could not be implemented especially in the wake of several reports of multilayered shell companies, money laundering etc. Ultimately, the Government notified the Rules regulating the number of layers of subsidiaries, i.e. Companies (Restriction on Number of Layers) Rules, 2017. Another important development has been the inclusion of a detailed provision on identifying 'significant beneficial owners' (Section 90 of the Companies Act, 2013 as amended by the Companies (Amendment) Act, 2017 w.e.f. 03.01.2018.) and its reporting mechanism (Companies (Significant Beneficial Owners) Rules 2013 w.e.f. 14.06.2018.). These provisions have significantly raised the bar of corporate governance norms and is a significant step in putting a check on corporate frauds through shell companies.

2.9 Credit Rating Agencies: When the Reference Point Itself Fails

Credit rating agencies serve as an important check on the financial strength of the company and guides the investors about the financial health of a company including corporate governance practices, for example ICRA's Stakeholder Value and Governance (SVG) Rating. *Infrastructure Leasing & Financial Services Ltd. (IL&FS) fiasco* has brought yet another dimension of corporate governance failure, including the role of credit rating agencies. Investors and creditors have questioned the role of credit rating agencies in IL&FS case as to how the bonds and loan rated as 'AAA' could turn into 'default' grade in two months. While SEBI is monitoring the developments in this matter, the regulation of credit rating agencies is again under scanner and possibly for another reactive reform ("SEBI tightens noose" 2018).

IL&FS Case: This is an unique case of corporate governance failure as it brings to the fore the questions relating to governance of financial institutions in the Indian Context. This also brings forward the conflict between the interests of 'shareholders' and 'creditors', naturally creditors pledging more risk in the enterprise than the equity holders (Varottil 2018). This case brings forward the requirement of a proper 'functional' risk management framework in place, especially in institutions dealing with public finance. Kotak Committee (SEBI 2017) has recommended for a comprehensive 'Stewardship Code' for financial sector in India, wherein the managers give prime importance to the interest of his/her organisation over and above their personal benefits and is driven by their personal reputation (Fernando 2012).

2.10 Directors and Their Accountability

CA 2013 brought out several reforms not only applicable to listed/public companies but also to private companies, especially, in terms of fixing the accountability of directors. Directors are the backbone of corporate governance framework. 'Independent Directors' further play a significant role in keeping this backbone uncompromised. Independent directors serve as an important check and balance system (EY 2012). However, in the past it has been noted that 'independent directors' have failed in their duty to check mismanagement or high-handedness of certain executive directors due to their conflict of interest. Independent directors were taken for 'namesake'. While scenarios have changed post 2013 Act, due to increased accountability of independent directors, still, the corporate prefer an 'easy-going' independent director than a nudgy one which keeps on reminding the board of its rules. While there is no specific empirical study done in this regard, a general overview of independent directors on boards of Indian companies would reveal closeness to the executive. While they may not fall foul of the letter of the law, whether they will qualify in spirit is a question.

Disqualification of Directors—Directors are the core to implementation of 'corporate governance' principles and one of the primary requirements of corporate governance relates to transparency through proper disclosures and reporting. It was a sorry state of affairs in September 2017 when more than three lakh directors had to be disqualified under Section 164(2) of the CA 2013 as their respective companies had failed to file financial statements and annual returns for more than 5 years, getting themselves tagged as 'shell companies'. Triggered by this disqualification and subsequent events, MCA launched a fresh drive requiring the directors in India to undergo a verification of their mobile numbers and passport details through e-KYC in the wake of fraudulent directors flying out of the country like *Nirav Modi, Vijay Mallaya, Mehul Choksi* etc. The aforesaid disqualification though has been challenged in many High Courts and NCLT on technical and natural justice grounds, episode highlighted an area which needs attention of regulators.

2.11 Fixing CEOs Pay—Judge in Its Own Cause

Executive compensation and corporate governance issues have been a matter of debate and attention for regulators, media and academics (Clarke and Branson 2012). In India, the Nomination and Remuneration Committee, a committee of the board comprising of majority independent directors, formulates the policy for remuneration of directors (Section 178 of the CA 2013). Infosys, one of the companies in India sworn for its ethical practices and corporate governance norms, had to deal with the issues surrounding higher executive pay to its CEO, *Vishal Sikka*. The founding shareholders of the company including *Mr. Narayan Murthy* were not happy with the handling of corporate governance ethos of the company and *Mr. Vishal Sikka* had to resign. This case also raised an important issue of 'controlling founders' and 'succession planning', as also witnessed in the *Tata-Mistry Case*. While both the cases of Infosys and Tata-Mistry involves stalwarts of corporate India leaving no iota of doubt to question their ethics and corporate governance, the question is whether this kind of a parental control of boards could lead to corporate frauds in some cases? MCA has now provided for a requirement of shareholder's approval for fixing managerial remuneration beyond the prescribed threshold (Amendment to Schedule V of CA 2013 w.e.f. September 2018).

2.12 Banking Frauds—Rising NPAs—RBI's Response

Banking system plays an important conduit in all sorts of corporate frauds, be it *Harshad Mehta Scam* or *Nirav Modi's* fraud. Banking industry has been gamed by fraudsters and scamsters many a times using different tools and mechanisms. Corruption of employees of the banks have been one of the primary reasons for such scams. However, we are concerned in this paper with the failure of corporate governance framework in banks, leading to corporate frauds. Several nationalised banks giving loans to *Vijay Mallaya* of *Kingfisher Airlines*, who was struggling with his losses at that point in time, raised questions of compromising corporate governance principles and political interference with the system in sanctioning the loans (Balakrishnan 2016). RBI's (Reserve Bank of India) observations on the Yes Bank's lapses in the functioning and governance of the bank due to its MD&CEO's control over the bank was of serious concern, especially private banks wherein the MD&CEO is likened as the "owner" of the bank putting corporate governance principles on shelves (Sreenivasan 2014).

Chanda Kochhar—ICICI Bank Case—Much credit goes to the rising NPAs and tighter norms post IBC and its direct and focused application to the banking sector for bringing this case forward. In a normal environment, this case may not have got the kind of scrutiny it got. The matter involved breach of corporate governance norms and serious conflict of interest issues in granting of loan indirectly tracing back to her spouse. On the issue being raised by a whistleblower in 2016, rather than acting upon the issue, the ICICI Board expressed full faith and confidence on their MD & CEO, *Ms. Chanda Kochhar*. The issue only got attention in May 2018 when SEBI issued a notice in this matter. Ultimately, *Ms. Kochhar* requested for an early retirement which was accepted by the Board. However, Central Bureau of Investigation (CBI) is still seized with the case. This case again brings before us the point that no one is infallible and relaxation of any of the corporate governance norms, in this case MD&CEO failing to disclose conflict of interest, may prove fatal. This case was not like a corporate fraud in true sense, but demonstrates how casually we take the basic principles of corporate governance which are touchstones of transparency and fairness in corporate dealings. This is the very mechanism which puts investors' confidence upbeat and trust in the system.

2.13 Frauds in Corporate Insolvency

Insolvency related frauds generally takes place few months before the anticipated insolvency wherein the existing directors/board transfer assets with an intent to defraud the creditors propositioning to claim during the insolvency proceedings (R3 2015). Company law generally provides for the mechanism to penalize '*fraudulent preference*' transactions wherein the company puts a creditor in better position than others at the time of liquidation by virtue of an action six months prior to the liquidation (Section 328 of CA 2013). In 2016, the rules of the game of corporate insolvency has changed with the introduction of Insolvency and Bankruptcy Code, 2016 (IBC); the philosophy of 'creditors in control' in IBC has replaced the 'debtor in control' in company law.

In India, the Sick Industrial Companies Act (SICA) was prone to misuse, to show false sickness and was a recipe to perpetuate dishonesty, fraud and illegality. It protected the negligent management on 'welfare' grounds at the cost of creditors' investment. The position has now changed with IBC wherein a declaration of corporate insolvency by NCLT moves control of the company to an independent insolvency resolution professional (IRP) for first 30 days and ultimately to the Committee of Creditors (COC) during the resolution period of 180 + 90 days. During this period of resolution, the IRP and/or COC is required to follow all the corporate governance norms. This new mechanism under IBC brings forward new challenges and possibilities of 'corporate frauds'. IBC has contemplated them in advance and provided for punishment for transactions defrauding creditors (section 69), fraudulent trading or wrongful trading (section 66), etc.

Jaypee Case: The insolvency resolution professional in the case of Jaypee Infratech had alleged that 'mortgaging of 858 acres of land' by the company to secure loans for its sister concern Jaiprakash Associates amounted to 'asset stripping' and falls foul of section 66 of IBC. Later, NCLT annulled the mortgage terming it as 'fraudulent, preferential and undervalued'.

Amrapali Case: This case brings forward another dimension of IBC and its potential abuse by the debtors to seek respite from the creditors. However, in this case, the Supreme Court has intervened taking cognizance of the plea of home-buyers that their investment do not get any protection under the IBC. Latest developments in this case shows serious frauds including diversion of funds, benami transactions and much more calling for a separate case study.

It is alarming to note that the resolution professionals handling the insolvency cases have reported fraudulent transactions in over 110 companies for an amount involving more than Rs. 40,000 crore. This includes 10 out of 12 cases that were referred to by RBI (Subramanian 2018). The aforesaid brief analysis of IBC and potential of corporate frauds in this sector opens up a new area of research and calls for stronger 'corporate governance' framework during and in the 'twilight zone' (time period before the commencement of insolvency) of corporate insolvency.

2.14 Response to a Corporate Fraud—Focus on Corporate Governance

A study on post-fraud responses by firms, reveals increased focus on improving corporate governance and audit committee practices (Farber 2005). India has witnessed several of these responses in terms of legislation and independence of the board. However, one of the major challenge has been defining the terms like 'independence', "as being a state of mind, it is difficult to 'legislate' since the exclusion of all types of personal ties to promoters is not possible in an environment where patronage is a way of life" (Roy 2018). In *Jaypee Case*, Supreme Court restrained the independent directors and their families from transferring any personal assets without court's permission. This triggered a chilling effect on independent directors and a case of extreme governance. The question is whether this will deter good people to join boards of companies?

Balancing with 'Ease of Doing Business': There is always a debate around what should be the right amount of pressure on corporate governance levers vis-a-vis 'ease of doing business'. Repones to the World Bank's "ease of doing business" parameters have caused a number of corporate governance levers to be eased. One of them was omission of Section 11 of the CA 2013 which dealt with certain declarations by a company having share capital before commencing its business (Companies (Amendment) Act, 2015, w.e.f. 25.05.2015). However, later the provision has been reintroduced as section 10A requiring the company to provide a declaration as to confirmation of payment of share capital by the subscribers of the Memorandum before it commences its business or exercises its borrowing power [by Companies Amendment Ordinance 2018 w.e.f. Nov. 2, 2018; later replaced by Companies Amendment

Ordinance 2019 w.e.f. Jan 12, 2019]. CA 2013 has seen several changes as above, like the omission of provisions relating to insider trading (section 195). This demonstrates that a regulation requiring tougher requirements of corporate governance shall also keep itself alive to the challenges of implementation and be conscious of its chilling effect on corporate sector.

2.15 Conclusion

India's Corporate Governance framework has traditionally been rooted in the concept of 'trusteeship' which finds its elaboration in the religious scriptures of *Bhagwat Gita* to writings of Mahatma Gandhi (IICA 2015). The concepts of *Dharma* (righteousness) and *Lok Sangraha* (transparency of work for public benefit) were essential elements of doing business which required management to focus on doing effective (result oriented) activities in an efficient (cost saving) manner (Bakshi 2016). However, these principles of virtue have been dented over time and appropriately put by *Vinoba Bhave*, a social reformer, "at present when money has usurped the place of *Lakshmi* (the Goddess of Wealth) untruth is being counted as cleverness, cruelty is regarded as skill and truth is divorced from trade." The present corporate governance scenario in India has been pointedly reflected by Roy (2018) as "the effectiveness of boards in corporate India, is the high concentration of ownership, shortage of experienced directors, non-existent procedures of appointment of 'real' independent directors, underdeveloped legal regimes and the lack of an efficient market for corporate control".

The paper establishes through several examples that the failure of corporate governance has led to several corporate frauds in India and the reforms have not been sufficient to control corporate frauds. What is an answer to this problem? Following could be some of the suggestions.

Use of Technology: Technology plays a significant role in perpetrating corporate frauds; however, it is equally useful in catching them (KPMG 2016). Use of Technology and Data Analytics have been utilized by the corporate audit firms to find out red flags and investigate the breach of internal controls. How Artificial Intelligence (AI) can be explored to detect corporate frauds would be the next thing.

Shareholder Activism: Shareholders serve as the counterbalancing force to keep boards vigilant and deter fraudsters. However, in India, shareholders are not very active (Singh 2010). While there are initiatives of financial literacy taken by MCA and SEBI, it still requires an aggressive push, as the numbers of financial frauds doesn't seem to decrease.

Educated and Independent Board: Members of the Board play an important role, especially the independent directors. Kotak Committee (SEBI 2017) has already recommended for a formal induction of new independent directors and formal training during intervals especially with respect to governance aspects.

Addressing CEO connectedness: In India we have family-owned businesses and even after these businesses operating as public companies cannot overcome the issue of CEO connectedness. Be it *Reliance, Tata, Mahindra, Wipro* or *Infosys*, the perceived family influence continues to be there. For the companies listed above, this connectedness works well, but for many others, such connectedness may provide for an opportunity to perpetrate corporate fraud. A sooner realization and addressing the same is necessary.

Addressing Emerging Defaults: The corporate governance framework shall keep a tap on the latest developments and challenges. For example, we noted the challenges posed by the IBC and dealing with institutional investors. There have been cases of CSR model being utilized for money laundering, fabricating CSR spending, etc. These are new challenges requiring solutions.

Promoting Ethics and 'Fraud-Free' Corporate Culture: Howsoever well written corporate governance code may be up for a game, if the businesses are formed for committing a fraud. There may be cases, where 'ethical practices' bind the companies to the corporate governance norms. There has to be a movement from narrow to a broader vision of corporate governance, i.e. 'focus on separation of ownership and control' to 'addressing expectations of different stakeholders—creditors, employees, customers and society at large' (Fernando 2012). Early focus on 'fraud-free' corporate culture could be an answer, as prevention is better than cure.

Notes

PACL Scam related to a company which ought to have been registered as a Collective Investment Scheme (CIS) failed to do so and the judicial tangle in the matter led to the scam take a magnitude of Rs. 49,000 crore. See Subrata Bhattacharya vs. SEBI, CIVIL APPEAL NO. 13301 OF 2015 order dated 02.02.2016 (Committee was constituted with Justice R. M. Lodha, former Chief Justice of India as its Chairman, for disposing of the land purchased by the PACL Ltd.)

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Chapter 3
Mitigating White Collar Crimes: A Governance Reform Agenda

Rakesh Kumar Sehgal and R. L. Koul

Abstract In wake of increasingly globalised markets, competition and advancement in technologies, businesses are becoming more prone to frauds in the nature of white-collar crimes as occupational frauds due to avarice of those involved in the value chain of governance. The term 'fraud' has different connotations and ranges from deception to dishonesty and includes corruption and conspiracy to embezzle money forcing the Sovereigns to have adequate AML risk assessment framework in addition to existing legislative and regulatory framework to mitigate business risks of fraud. A 2018 global study by Association of Certified Fraud Examiners on occupational frauds evidences \$7 billion losses with 89% through asset misappropriation schemes resulting in a median loss of \$114,000 and financial fraud scheme though accounting for 10%, evidenced \$800,000 as the median loss. This remains the tip of the iceberg with many of the victims tending to underplay existence of the fraud to curb the reputational risk. A typical risk mitigation strategy towards fraud prevention revolves around building up framework to assess the vulnerability of systems, processes and people to raise red flags for fraud detection, prevention, cessation and response system and building up adequate internal and external controls as part of enhanced governance ecosystem. The global jurisprudence around the white-collar crimes is evolving. The developed countries have brought in suite of legislations; the regulators of securities and financial markets along with accounting/auditing profession domestically and internationally is developing standards and guidelines for compliance and related capacity building. In India, the Companies Act, 2013 has provided more teeth for fraud prevention and control for an enhanced governance ecosystem. While there being no best fit approach, global developments around regulatory enforcement for fraud deterrence and control provide a scalable benchmark for Indian context.

Keywords White collar crimes · Vulnerability · Business risk · Governance ecosystem · Control mechanism · Regulatory enforcement

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3.1 Introduction

The reverberations of the 2007–08 financial crisis followed by the great recession as a vortex plagued the global economic activity and these developments remain a *cause celebre* for the cascading risks it brought with it as a financial market apocalypse. The financial crisis, which primarily occurred due to sub-prime loans, credit defaults swaps and large leverage ratios (firms' ability to pay debt) led to a fat tail risk highlighting downside risk that was so improbable to be predicted as being an extremely outlier event. The financial depression arising out of 2008 events belied the conventional wisdom of a normal distribution bell curve wherein majority of the assets would fall within its three standard deviation of its mean to assess the risk and volatility; as herein the outlier occurrences with 0.3% probability of an extreme risk did happen; causing the serenity in global financial markets to collapse.

The obscurity though now seemingly unfolded; highlights in hindsight the white-collar crimes and failure of all layers of governance as the chief protagonist for the stymied consequences that led to sequence of events to financial turmoil globally. Though there have been great lessons learnt since this financial catastrophe, the "fat tail risks" arising out of potential "black swans"—still loom large as there has been evidence of consistent and persistent professional misdemeanour ranging from deceit, deception and subterfuge to artificially manipulating an agenda to build illegitimate private gains thus bringing to fore the resultant risk and vulnerability to the governance ecosystem by those charged with governance (Wells Joseph 2003). Such crimes are done by surreptitious means which shrouded in haziness of legality or otherwise; the conduct may just border on legal premise but may lead to illegitimate consequences altogether through the fraudulent behaviour at workplace, and from detection and deterrence perspective; it would need to be seen whether it is a regular business practice and whether that business practice will lead to a crime when extended beyond what the law permits.

While the expression "The Black Swan" was used by Aristotle in his work 'Prior Analytics' (Alexander et al. 1991) to construe it to be as a highly improbable event; in 2007, Nicolas Taleb, coins the Black Swan Theory (Taleb 2007) exemplifying the highly improbable events with catastrophic effect and the human tendency of finding simple explanations to such events retrospectively; the underpinning objective being to identify areas of vulnerability to build up resilience to the commotion resulting through the negative events.

When Ronald Reagan in his address before the Congress had quipped 'Government is not the solution to our problems; Government is the problem; it endorsed the Chicago school of thought veritably. Kenneth Davidson (2011) highlights the negatives of deregulation prompted through *laissez faire* economy and in particular the Chicago economics resulted in the downfall of the financial markets as the 1933 Glass Steagall legislation (Banking Act of 1933) which separated commercial and investment banking was repealed through Gramm Leach Bliley Act 1999 to do away with the restrictions between commercial and investment banking which is presumed to be the prime reason for the financial market apocalypse of 2008.

Sustainability of business in a complex era faces many dilemmas and challenges unforeseen before, be it rise of *laissez faire economy* arising out of increased liberalisation, globalisation, innovations at marketplace through disruptions and very nature of state regulatory intervention towards regulation of economic enterprises. In this background while the economy's world over still grapple with challenges of trust, relevance and technology; there are shifting sands of corporate governance with increased evidence of white-collar crimes perpetuated as occupational frauds.

3.2 How the Corporate Crimes Surfaced?

The shifting sands of corporate governance through state interventions of varying regulatory force as "ex-post" measures globally before and immediately after the great financial depression manifest in themselves the endemic nature of financial crimes as misdemeanours through occupational frauds. That the economic non-state actors, policy makers and the state are yet to fully evolve to an occupational crime free governance eco-system and still remains elusive dream. Figure 3.1 highlights the series of corporate frauds and related scandals in which white collar crimes were the prime triggers and the manner in which these frauds took place in seriatim, highlights the need for more and more research in the area and how to regulate the ethical dimension of the businesses and the natural persons who occupy key positions in the governance chain given the high stakes involved.

Paradoxically as the chorus for enhanced corporate governance gains momentum; the requiem caused through financial erosion; though by isolated instances have tsunamic consequences on the financial stability and trust in those charged with governance who ought to have the legal responsibility to remain committed to interests of stakeholders; which comes under shroud of scrutiny. In run-up to controlling internal risks and absorbing external shocks; the fiduciary role and responsibilities thereof to act as bailees of preservation of serenity in the financial and operational transparency and disclosures gets vitiated as occupational crimes in nature of embezzlement, fraud, corruption, misappropriation, mis-statement and alike pave way for caprice and avarice of those holding fiduciary positions in the value chain of governance and thus cannibalising the very interests of stakeholders which they are legally duty-bound to protect and enhance. In race to value creation for stakeholders, the see-saw between cherished goals of good governance and pecuniary gains to responsible corporate officers has been rather skewed in wake of increasing exposure to financial markets (Mark and Joseph 2012). As in the anti-trust violations, wherein it is said that the "winner takes all", herein the fraudster who is an insider through his occupational insight squanders for private gains and by the time the deception comes to light or full-blown symptoms appears, the money is not recoverable.

The above highlights that the Black Swans no longer remain outlier events and have been resurfacing time and again as opportunist malaise to erode the trust of stakeholders and lead to financial stability.

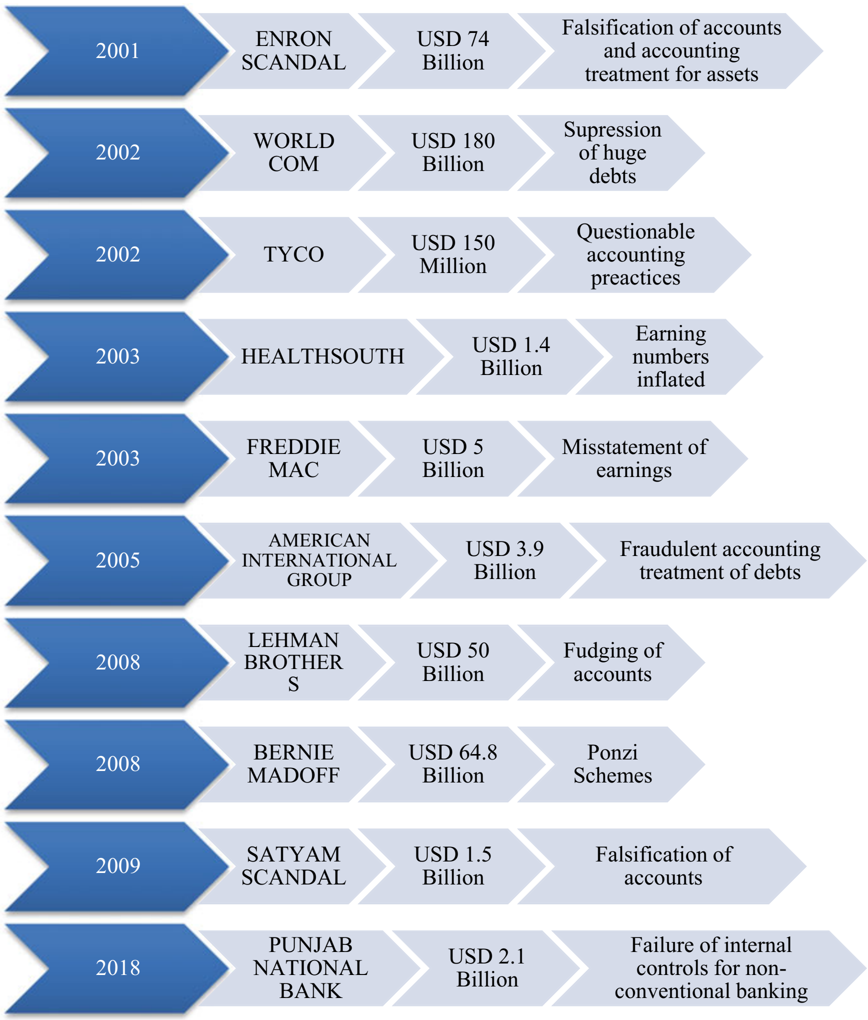

Fig. 3.1 Size and nature of white collar crimes. The ten worst corporate accounting scandals of all times available online at https://www.accounting-degree.org/scandals/

3.3 White Collar Crimes: Lurid Imagery

The occupational frauds at the workplace are in nature of corporate frauds perpetrated for illegitimate gains and can be said to be economic crimes. Still regarded as a venerable work (Sutherland and Edwin 1940), white-collar crimes as originally coined by Professor Sutherland in 1949 were attributed as occupational crimes for violation of law committed by respectable persons during the course of occupation. Ever since the first usage of white collar crime as above, the National White

Collar Crime Centre has come out with the definition of white-collar crime as "illegal or unethical acts that violate fiduciary responsibility of public trust, committed by an individual or organization, usually during the course of legitimate occupational activity, by persons of high or respectable social status for personal or organizational gain (Cliff and Wall-Parker 2017)."

There has been increased evidence of occupational crimes and global economies grapple through curse of White collar crimes**.** Carried out by those in fiduciary positions, they are distinctively different from street crimes and are characterized by a variety of offences committed by powerful people or organizations. The most common white-collar offenses include antitrust violations, bankruptcy fraud, bribery, computer and internet fraud, counterfeiting, credit card fraud, economic espionage and trade secret theft, embezzlement, environmental law violations, financial institution fraud, government fraud, healthcare fraud, insider trading, insurance fraud, intellectual property theft/piracy, kickbacks, mail fraud, money laundering, securities fraud, tax evasion, phone and telemarketing fraud, and public corruption.

Such economic offences are obscured by cover of legitimacy and the impact is on society and the aim of deterrence should be on controlling the internal risks and absorbing external shocks as these result from caprice and avarice of those holding fiduciary positions in the value chain of the governance and cannibalising the very interest of stakeholders they are duty bound to protect and promote.

3.4 What the Research Globally Evidenced?

A 2018 Report (The Global Risk Report 2018) highlighting Global Risks and Trends categorise illicit trade covering financial flows, tax evasion and organised crimes, asset bubbles, financial mechanism failure and fiscal crises as the perceived major economic global risks which are going to cause major vulnerabilities to the economic and financial governance in times to come. The Report assumes significance as the global economy at large is still recuperating from the exacerbating aftermath of financial meltdown just a decade before. These Global Risks have the tenacity to cause vulnerabilities affecting the globally interconnected world.

A study (Global study on occupational Fraud 2018) by ACFE across 125 countries, covering 2690 cases point out that USD 7 billion were incurred as total losses with financial statements and fraud schemes though covering only 10% of the cases were most loss inflicting with USD 8,00,000 median loss. The Report highlights that both small and bigger business suffered because of internal control weakness accounting for half of the frauds. The Report is important to understand the dynamics of methods of occupational fraud; means employed thereto, characteristics of victim organisations and tricksters. The Report further highlights assets misappropriations, financial jugglery and corruption in combination of one and other as the prime hotspots and the prime black holes resulting from internal control weaknesses.

A 2017 Report (World Development Report 2017) while outlining rethinking governance for development asserts highlights the meanness of corruption as the biggest challenge for building blocks of development. Drawing an analogy from the report which makes commitment, coordination and cooperation as the 3 core functions of institution for effective policy implementation space, the same can be said to be true of the governance space as well to put an end to 'accountability for sale'.

There are major risks attached to increase in institutionalised corruption culture in corporations and it is not only the economic activity and actors which are facing the aftermath of this problem. There have been global instances of political corruption as well wherein the state machinery under the political leadership indulges in this nefarious activity bringing problems of extortion, political and legal risks, violence and alike in the civil society.

An Oxfam study (An economy for the 1% 2016) points out that 9 out of 10 companies are present in tax heaven and during 2001–2014, corporate investment in tax heavens has increased by 400%. Coupled with increased focus of liberalisation, privatisation and globalisation, an increased move towards deregulation; those at the higher echelons have amassed big fortunes to the extent that the wealth of 1% of rich today is higher than 'rest of the world'. Another estimate (Alstadsaeter et al. 2017) estimates 10% of the world GDP parked in tax heavens. A report by Federal Bureau of investigation estimates the white-collar crime to cost over $300 billion to U.S economy.

Just around the backdrop of great financial depression, a 2006 study (Corporate Governance 2006), had identified drivers of corporate governance with scandals (rank 1), compliance (rank 2) and risk management (rank 5), the study then makes a swift departure to Corporate Governance as a Business Imperative.

3.5 Taxonomy of Occupational Fraud: Detection and Deterrence Thereof

Taxonomy of fraud (World Development Report 2017) has been identified to consist of a 'fraud triangle (Abdullahi and Mansor 2015)' through a crisis of 'pressure' (pressure to indulge/commit fraud/corruption for gains), 'opportunity'(arising out of black holes and poor internal controls) and 'rationalisation'(justifying the misfeasance as the proper conduct) and in this era characterised by technology, it has added element of 'capability' (knowledge of digital governance to commit e-fraud) thus, making it as a 'fraud diamond'.

Samuel Buell in his work (Buell 2016) dwells upon the nature of white-collar crimes and how the risk-taking behaviour as legal innovation is used to drive corporate agenda. The complexities involved in demystifying such a business crying are equally complex as such crimes are done by surreptitious means which are soaked in haziness of legality or otherwise. Many times, such conduct just bordering on legal premise may have illegitimate consequences altogether. A fraudulent behaviour at workplace; is it a regular business practice and whether that business practice will lead to a crime when extended beyond what the law permits; whether the *mens rea* to commit fraud was there; did the fraud actually take place; is the business practice innovated to an extent that it is compliant to general norms but still detrimental to financial standing; all these are questions which become relevant in context of new kind of offences which businesses may pass on as a 'tort' rather than a crime (Olejarz 2016); whether the opportunity element allows investigation to permeate the sequence leading to white-collar crimes (Benson 2015).

The complexities in detection, investigation and deterrence arise due to smoke choked conduct associated with occupational frauds like insider trading, diversion of funds, misappropriation in financial statements through overriding/underwriting, treatment of assets, liabilities, receivables and non-performing assets which may be subject to varied differential treatment. As a result, new murkier forms of business conduct keep on evolving in a veil of legitimacy though the intention is to deceive for usurping financial gains (Rosoff et al. 2010).

The fraud exposes the organisation and the stakeholders to strategic perils which can be classified into internal external regulatory and reputational race not discounting the financial risk. Given the catastrophic consequences that occupational fraud brings along, a Report (Pulling fraud out of the shadows 2018) highlights that instances of fraud over last few decades are consistent and persistent. The Report based on a Global survey assess the 'eruption of fraud' in different on self-assessment basis and goes on to evaluate the steps undertaken at corporate level for fraud control mechanism highlighting increased awareness in the subject matter to control financial, operational and reputational risks.

3.6 Evolving Jurisprudence in Fraud Risk Mitigation-'Ex-Post' Measures

Occupational crimes is a complex problem affecting business and governments equally around the globe with no country/business regardless of its size and standing being an exception and any turmoil of financial and related frauds, derail the confidence of the investors, strategic partners and other stakeholders. With global interconnectedness of trade and policy-making space, the new trade order has seen the framework of 'fraud mitigation management' more than a domestic legislation issue; the problem getting the attention of sovereigns across the globe and other intergovernmental organisations equally.

There is an increased shift to find more proactive approaches to fight fraud, corruption and bribery risks principally through anti-bribery/anti-corruption legislations and increasingly globalised forms of enforcement to put at bay the erosion to investors and public confidence in the policy and economic governance space. Increased pressure on the corporations to be in one up man ship and masquerading the financial numbers through financial ingenuity evidenced to be on rise given the Black Swan event around last two decades.

Since such occupational white crime frauds are being perpetrated by insiders and those charged with governance, the difficulty lies in crackdown on them due to chicanery and deception till full-blown signs of the epidemic starts surfacing and by that time considerable time and opportunity is already lost in its prevention. The issue becomes further very complex because by the time the fraud is discovered, the money is either unrecoverable or chances of a miniscule amount of the same getting recovered is virtually negligible while being a costly, time-consuming and legally entangled complex process.

There are green shoots visible in terms of awareness to the menace of occupational crimes and intergovernmental organisations like World Bank, Organisation for Economic Co-operation and Development (OECD), United Nations, International Monetary Fund through the Financial Sector Assessment Program for anti-money laundering/counterfeit trading and various Non-State actors like Transparency International who have been playing advocacy role in disseminating knowledge and awareness for combating the risks arising out of bribery, corruption, tax heavens and money laundering.

While the USA was the first country to enact a legislation namely, Foreign Corrupt Practices Act (FCPA) to deal with domestic and cross-border corruption in 1997. Then 34 OECD member States signed an anticorruption Convention to deal with issues of Cross-border corruption. The UN Convention against Corruption (2003), which has retained the key elements of the OECD Convention, was again a benchmark for a global anticorruption legal framework towards establishing a global standard and making the giving /soliciting of bribery as a criminal offence.

The FCPA Act which earlier extended for the instances of bribery money inside the US, also applies to foreign companies listed in USA and is one of the focused areas of compliance and enforcement by the US Securities and Exchange Commission (SEC) in unleashing global drive along with OECD against bribery and corruption. Paying a bribe to a foreign official or a foreign political party to obtain or retain business is a criminal offence. Post 1988, the Act covers the US Citizens and companies throughout the world and imposes criminal and civil penalties and even incarceration once a murky deal is detected. The limitations under the Act are illicit payments which are lawful under the regulations of foreign official's country and the legitimate business expenses.

While the economic world shivered under the aftermath of series of accounting failures, the era in the dawn of twenty-first century saw series of new legislative reforms across the developed and developing countries to tackle the menace of white collar crimes. Table 3.1 (Fraud risk management 2014) below highlights some of the regulatory changes which took place in the economic governance space and move towards the regulation of economic frauds.

Table 3.1 Important Regulatory changes globally to deter Economic Crimes

Year	Country	Regulatory Reform to Economic Crimes
1980–1990	USA	Defense Industry Initiative on Ethics and Business Conduct (1985)
1990–2000	Australia	Commonwealth Criminal Code Act
	USA	Sentencing Guidelines for Organizational Defendants
	USA	Caremark Decision
	USA	COSO Internal Control Framework (1992)
2000–01	USA	Department of Justice Enforcement Guidance (Holder Memo 1999)
	European Union	Financial Services Action Plan
2001–02	USA	PATRIOT Act
	USA	SEC Statement on the Relationship of Cooperation to Agency Enforcement Decisions
	Australia	Corporations Act (including CLERP 9 Amendments
2002–03	USA	Statement on Auditing Standards (SAS) 99
	USA	Sarbanes-Oxley Act of 2002
	United Kingdom	Proceeds of Crime Act 2002
	India	Prevention of Money Laundering Act 2002 Central Vigilance Act 2003
2003–04	USA	Department of Justice Enforcement Guidance (Thompson Memo)
	USA	NYSE and NASDAQ Listing Standards
	United Kingdom	The Combined Code on Corporate Governance
	United Kingdom	The Money Laundering Regulations
	European Union	European Council on Economic Fraud
2004–05	USA	PCAOB Auditing Standard No. 2
	USA	Revised Sentencing Guidelines for Organisational Defendants
	United Kingdom	Companies Act of 2004
2005–06	United Kingdom	Revised Combined Code with Turnbull, Smith, and Higgs Guidance (2005/2006)
	European Union	Third Directive on the Prevention of the Use of the Financial System for Money Laundering or Terrorist Financing
2006–07	USA	Stone v. Ritter
	USA	Department of Justice Enforcement Guidance (McNulty Memo)
	USA	SEC Statement Concerning Financial Penalties
	United Kingdom	The Fraud Act
	European Union	The Anti-Money Laundering and Counter Terrorism Act
2007–08		

(continued)

Table 3.1 (continued)

Year	Country	Regulatory Reform to Economic Crimes
	USA	PCAOB Auditing Standard No. 5
2008–09	USA	Financial Recovery Act
	Australia	AS 8001–2008 Fraud and Corruption
2009–10	USA	Department of Justice Enforcement Guidance (Filip Memo)
2010–11	USA	Revised Federal Sentencing Guidelines
	USA	Dodd-Frank Act
	United Kingdom	Bribery Act
	India	Draft Central Beuaru of Investigation Act 2010 (repealing Delhi Special Police Establishment Act 1946)
2012–13	Australia	Fraud Control in Australian Government Entities
	India	Prevention of Corruption (Amendment) Bill 2013 amending Prevention of Corruption Act 1988 Companies Act 2013
2015	India	The Whistle Blowers Protection (Amendment) Bill, 2015

3.7 Role of Internal Control in Prevention and Detection of fraud-Éx-Ante Measures

The Practice Advisory 2130 by the Institute of Internal Auditors (IIA)-(an international professional association as the global voice for internal audit, a standard setter and its members spanning around internal audit, risk management, governance, internal control IT audit and security) dwells on the role of the internal audit activity and internal audit function in sustaining the ethical culture of an organisation. IIA advisory inter alia lays down that internal auditor while making their annual internal audit plan should not only consider the organisation's assessment of fraud risk but should also review its fraud management capabilities on a periodical basis. It further goes on to state that the internal auditors should apart from communicating with the key management personnel should also interview all personnel associated in the organisation's risk assessment strategy chain to help them sensitize and ensure appropriate coverage to all fraud risks. The said Practice advisory also makes it obligatory upon internal auditors to evaluate with due scepticism the purported internal control mechanism while carrying out the internal audit engagements to evaluate and review the internal control in place for fraud mitigation and detection. Any potential frauds detected during internal audit control engagement are required to be dealt with the relevant professional and legal standards.

As far as the audit engagements are concerned, the Institute of internal auditor practice advisory 1210-A2-1 deals with the auditors' responsibilities relating to fraud risk assessment, prevention and detection and provides guidance in the matter. Also, its practice advisory 1210-A2-2 deals with auditors' responsibilities relating to fraud investigation, reporting, resolution and communication.

The Committee of Sponsoring Organisations of the Treadway Commission (COSO) is a joint initiative of American Institute of CPAs, IIA, American Accounting Association, the Institute of Management Accountants and Financial Executives International. COSO was set up in 1985 and it works primarily to develop integrated guidance on the internal control to combat fraud. COSO framework on internal control has been designed to provide reasonable assurance with regard to operational efficiency and effectiveness, reliability of financial reporting and compliance with the applicable laws and regulations.

2013 COSO framework Principle 8 states that the organisation considers the potential for fraud in assessing risk for the achievement of objectives. COSOs Fraud Risk Management Guide 2013 (Fraud Risk Management Guide 2016) states that for managing the fraud risk, the responsibility lies with the board of directors, top management and personnel at all levels including the internal auditors. They are expected to be aware of the fraud risk management program, the identification of fraud risks, the prevention mechanism and the process in place to take steps for detection, investigation and corrective action. The internal auditors shall draw their internal audit plans commensurate with the organisation's fraud risk management plan in place and will report on the fraud risk management and internal control systems. The said framework is intended to help the internal auditors in setting context for control environment, risk assessment, communication and monitoring.

Managing the Business Risk of Fraud—A Practical Guide (https://www.acfe.com/uploadedfiles/acfe_website/content/documents/managing-business-risk.pdf) states that the importance attached to the internal audit function by the organisation is a sign of its commitment to effective internal control. The Guide states that the internal audit charter of the organisation should include internal auditing's role and responsibilities relating to fraud risk, investigation, reporting and ethics training. It further states that the internal auditing should have independent authority and reporting chain including access to audit committee and adherence to professional standards.

Despite the above framework in place for internal audit to prevent and detect fraud, it is important to examine the efficacy of the internal audit. To reiterate standard 1210—A 2 which states that internal auditors must have sufficient knowledge to assess the risk of fraud and the way in which the company manages that risk, but they are not expected to have a level of expertise as the person whose primary responsibility is detecting and investigating fraud. This in a way gives a limitation of the process of internal audit however, understanding and managing the risk of fraud through continuous capacity building to prevent and detect fraud is important (Dordevic and Dukic 2015). A 2014 (https://www.acfe.com/rttn/docs/2014-report-to-nations.pdf) report by ACFE highlights that the internal audit was able to detect 14.1% of frauds which was more in relation to accounting 6.6%, examination of documents 4.2%, external auditing 3%, monitoring activities 2.6% and IT control 1.1%.

3.8 Epilogue: Governance Reforms in Light of Combat Mechanism to Occupational Crimes

Despite suite of legislations, in deterring the economic offences related measures as *standards, compliance and disclosure* mandated through standard setters, research and advocaczy forums, occupational crimes remain unabated. Gary S. Backer points out that an offender is likely to weigh the ‘risk’ and ‘reward’ for indulging in an outlawed activity and if the rewards exceed the risk attached to such an action; whether the risk being pecuniary or incarceration; the offender is more likely to indulge in it taking into account from his perspective the low rate of detection vis a vis the windfall gains.

This demonstrates the need for integrated approach of ex-post and ex-ante measures as it requires a total re-orientation in outlook to create a governance ecosystem which is able to detect, deter and provides serious sanctions to recalcitrant behavior and tackle menace of frontal assault on good governance vitiated by economic crimes perpetuated as occupational frauds by having strong internal control framework in place along with integrity pacts with employees at all layers of governance (Becker 1968). More than the forced compliance, it is important to build up on ethics oriented business culture integrated with severe laws which act as a deterrent to potential occupational frauds due to legal consequences that may follow. Some of other issues which need attention are:

1. The fraud is all pervasive and has the potential to affect all kinds of organisations regardless of their size and it is important that building up from the lessons learnt in wake of corruption and corporate scandals in last over a decade which have drawn full public furore, all organisations need to identify the black holes with due mechanism to detect, deter and investigate fraud.
2. Gone are the times that the concept of fraud risk was limited to theft, bribery, corruption misappropriation and mis-statements in financial reporting chain. In this digital era, there has been a stark differentiation and emergence of frauds in unconventional areas like cyber crimes and issues like data security are becoming increasingly important. It is necessary that the empathisation amongst all set of organisations build up to realise that they are vulnerable to blind spots which have the tenacity to grow into full-blown financial frauds.
3. The fraud prevention strategy needs to be embedded as an integral component of the overall corporate strategy as different from a knee-jerk reaction and ad hoc and inconsistent approach for risk mitigation. In order to combat the occupational and other risks arising out of fraud, the organisations should work upon having due risk assessment systems in place to thwart the vulnerability threats to business growth. Some of the ‘fault lines’ which would need to be compulsorily addressed in such a strategy would include the following ‘risks’ arising out of anti-bribery and corruption, asset misappropriation, embezzlement, financial misstatements, regulatory compliances, data theft and piracy, anti-trust violations and violations in nature of business and professional misconduct.

As part of 'ex-ante' strengthening measures, it is important that these are not just passed as 'torts' but as economic crimes.

3.9 Complexities in Investigation Detection and Deterrence

As the UK office of fair trading has stated that we only learn not to repeat the mistakes of the past if we understand what caused them, the risk assessment systems as above should be coupled with display of early warning signals to identify weak spots in governance mechanism for controlling the risk of the white-collar crimes. A strong internal audit function should be coupled with having integrity pacts within the organisation and more than the regulatory compliance and enforcement; a strong ethical culture with a well-defined whistle blower policy with adequate protection and encouragement to such whistle blowers should also be put in place.

The risk assessment systems within the organisation should be upgraded as business maturity models where at the fraud risk and prevention is continuously assessed *suo moto* which will enable building up adequate firewalls to thwart such race at periodical intervals. It would also be important to assess the risk assessment systems with those followed by other industry players.

The organisations would need to build up effective communication strategy to mitigate a reputational risk response system, should a white-collar crime related risk arise so that minimal reputational damage to internal and other stakeholders including the regulators and investorsis there so that post any actual fraud, minimal further damage through mis-reporting is carried through.

The organisations would need to build up capacity across the entire value chain of the organisation so that all the internal stakeholders realise the gravity and potential consequences of a likely business crime in the nature of occupational frauds. Having such knowledge and resources within the organisation would build up adequate whistle blowers' database in the event of any occupational and related fraud.

Given the interface of technology platforms with business processes, it is important to use digital platforms which would also be able to capture emerging frauds arising out of e-commerce, social media campaigns, data security and other cyber crimes.

A Reformed Governance is an area we should keep working on and the need of the hour is to change the mindset to ethically compliant business behaviour to create a Reformed Governance Ecosystem.

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Chapter 4
Establishment, Inspection and Public Disclosure of Audit Quality Indicators

Süleyman Yükçü and Özlem Koçakoğlu

Abstract PCAOB (Public Company Accounting Oversight Board), based on the Sarbanes Oxley Act which was enacted following the Enron Scandal, was founded in 2002 to ensure the public oversight of independent audit enterprises. PCAOB, a private non-profit organization audited by SEC (U.S. Securities and Exchange Commission), has the authority to set standards and register aside from supervising and enforcing audit entreprises that undertake the independent audit of publicly held companies. Its powers were expanded to include overseeing the independent audit of brokers and exchange brokers upon the enactment of Dodd Frank Wall Street and Consumer Protection Act in 2010. U.S Department of Treasury founded ACAP (Advisory Committee on the Auditing Profession) in 2007, in order to research on concentration in audit industry, financial strength, audit quality and other similar topics and suggested the negotiated development of audit quality indicators by PCAOB with all interested parties. After that time, between the years of 2008–2015, within PCAOB, work groups were assembled, open discussions were organized, market-dominating practitioners and academicians were consulted, letters of recommendation were perused and existing studies on this subject were examined with the aim of establishing audit quality indicators. In 2015, as a result of a long and exhausting study, 28 audit quality indicators were presented to the public opinion following the completion of the initial stage. Indicators fall into three groups and have complementary quality. The fact that independent audit entreprises sincerely disclose the numeric ratios (audit quality indicators) regarding their audits on electronic environment will not only provide small companies struggling against the competition with a new tool but also provide investors with information regarding

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the audit quality. In Turkey, analysis of these indicators by KGK (The Public Oversight, Accounting and Auditing Standards Authority) through formation of databases will help drawing of inspection charts by determining risky enterprises and easier identification of the defective sections of the current standards. In this study, publicly disclosed guidelines of PCAOB were utilized and numerical examples of explanatory ratio calculations were given by us through creative brainstorming. In addition to this, a literature review was also conducted regarding audit quality. Aim of this study is to bring forward suggestions on introduction, inspection on electronic environment and public disclosure of audit quality indicators.

Keywords Independent audit · Quality · Audit quality indicators

JEL Classification M40 · M41 · M42

4.1 Introduction

Independent audit stands for the audit of enterprises' financial statement or financial information, which will be presented to public opinion or requested by Capital Markets Board of Turkey, with the aim of collecting adequate and appropriate independent audit evidences in terms of conformity to financial reporting standards and accuracy, through the implementation of all necessary independent audit techniques foreseen in independent audit standards via records, registers and documents and subsequently for compiling a report based upon an evaluation (Communique on the Independent Audit Standards in Capital Markets Serial: X, No: 22).

On the other hand, independent audit quality has been a much discussed topic for years, but not a well understood one. Currently there is not a consensus on how to identify and measure it. The indicators that establish and evaluate audit quality vary according to users, auditors, regulatory bodies, society and all the shareholders of financial reporting value chain.

Even though audit quality is perceived as the ratio of conformity with audit standards by most professionals, this point of view has not been enough to prevent accounting scandals. Fierce competition, instantaneous fluctuations in markets, asymmetric information problem between enterprises and parties benefiting from financial statements brought about the increase in independent audit quality's significance. On the other hand, audit firms' rarely disclose the underlying parameters of the process to the public opinion, rather than emphasizing audit quality as a slogan.

Competition between national and international institutions, countries and national and international blocks increasingly continue in business as life on earth. If we look 50 years back, the fierce competition was between United States of America and Soviet Union, with it's former name, in the field of space technology. U.S.A took the offensive with Apollo spacecraft series and made the name of Neil Armstrong, first man ever to set foot on the Moon, known by everybody, young and old alike.

Another incident of the space competition, imprinted in our memory, is the "Challenger disaster". While this narrative points out to the magnitude, successes and failures of space technology race, "Enron Scandal" took place in 2001 as the "Challenger disaster" of accounting field.

While near perfect audit was believed to be a real thing with the "Generally Accepted Accounting Principles" and "International Accounting and Auditing Standards" until the Enron Scandal, cases like Enron and Lehman Brothers uncovered many major and minor sized errors in independent audit process which was believed to function perfectly.

After that time, independent audit quality has gained significance and regulatory bodies has started to publish works on general framework of audit quality and to establish guidelines.

4.2 Audit Quality Indicators

U.S Department of Treasury founded ACAP (Advisory Committee on the Auditing Profession) in 2007, in order for the researching of concentration in audit industry, financial strength, audit quality and other similar topics. Final Report, published on October 6, 2008, charges PCAOB with the duty of improving key audit quality indicators and determining their feasibility through negotiating with investors, publicly held companies, audit committees, executive board members, academicians and other parties (U.S Department of Treasury, Final Report 2008: VIII: 14).

First conducted study within the institution regarding this subject was the meeting of Standing Advisory Group-SAG on October 2018. Aim of this session was evaluating the feasibility regarding the subject of improving key audit quality indicators by taking the report of Treasury into consideration (SAG Meeting 22–23 October 2008: 3). Subsequently, determining audit quality indicators in 2012–2016 Strategic Plan ranked among the near term priorities (PCAOB Strategic Plan 2012–2016: 5). At the Standing Advisory Group meeting of 15–16 May 2013, 40 audit quality indicators formed the framework of audit quality (SAG Meeting 15–16 May 2013: 8, 9, 10). By November of 2013, SAG had determined a set of criteria to allow for reducing 70 indicator proposals to 28 indicators that went on to form the framework of conceptual bulletin. Fundamental criteria for the following elimination is as follows: usefulness to audit committees/stakeholders, no unintended consequences, scalable, quantifiable and/or well defined, availability of data, not redundant, anticipate to be correlated with audit quality, leading indicators, anticipated precision of the signal, provides insights into possible root causes and etc. (SAG Meeting 13–14 Nov 2013, Slide 8). Efforts were finalized on 1 July 2015 and 28 indicators were presented to public opinion.

Indicators constituted a quantitative portfolio providing a new opinion on evaluation of audit quality and how to achieve high quality audit. It consists of 28 illustrative calculations on two levels labelled as engagement and firm.

Those 28 potential indicators fall into 3 groups. The first one concerns audit professionals and includes measures regarding "availability", "competence" and "focus" on performing the audit. The second one concerns the process and includes measures about an audit firm's "tone at the top and leadership," "incentives," "independence," attention to "infrastructure," and "monitoring and remediation". The third one is audit results and includes "financial statements," "internal control," "going concern," "communication between auditors and audit committees," and "enforcement and litigation" (PCAOB Release No 2015-5: 2, 3). Indicators consist of illustrative calculations on two different levels labelled as firm and engagement. But it's not always possible have illustrative calculations for every indicators on both levels. For example, regarding 13th, 14th and 26th indicators, only firm level calculation is recommended in order to provide adequate sample size and ensure the privacy of participants. 7th indicator, on the other hand, was calculated on engagement level (PCAOB Release No: 2015-5, 13). Illustrative calculations for 20th, 22nd and 23th indicators was not given and it was noted down that the subject needs more study. 20th indicator concerns professional competence test. In rapidly changing finance and business environment, a firm depends on auditors' professional competence to sustain it's audit quality. Even though the importance of continued training is often stressed, the fact that it doesn't require recertification makes it hard to measure it objectively (PCAOB Release No 2015-5, Appendix A-19). 22th indicator is concerned with fraud and other financial reporting misconducts. This ratio is one of the harder ones to calculate and establish because it necessitates the obtainment of information regarding the internal control system of the firm that covers fraud and error in order to calculate the ratios regarding this subject (PCAOB Release No 2015-5, Appendix A-21). 23th indicator is determining the audit quality via the measurements that show the financial report quality. This subject is also marked as a field that needs more study.

The audit quality indicators information envisioned by "PCAOB Release" comes most importantly from audit firms. The data for 19 of the 28 potential indicators can be obtained only from the firms (or, in one case, from an independent survey of firm personnel); the data for eight of the nine remaining indicators (the "audit results" indicators, indicators 21–28) can be derived from public sources, while the remaining potential indicator is a possible survey of audit committee members (PCAOB Release No 2015-25).

Chart 1. Available Potential Audit Quality Indicators

Audit professionals	Availability	1. Staffing leverage 2. Partner workload 3. Manager and staff workload 4. Technical accounting and auditing resources 5. Persons with specialized skill and knowledge
	Competence	6. Experience of audit personnel 7. Industry expertise of audit personnel 8. Turnover of audit personnel 9. Amount of audit work centralized at service centers 10. Training hours per audit professional

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	Focus	11. Audit hours and risk areas 12. Allocation of audit hours to phases of the audit
Audit process	Tone at the top and leadership	13. Results of independent survey of firm personnel
	Incentives	14. Quality ratings and compensation 15. Audit fees, effort, and client risk
	Independence	16. Compliance with independence requirements
	Infrastructure	17. Investment in infrastructure supporting quality auditing
	Monitoring and remediation	18. Audit firms' internal quality review results 19. PCAOB inspection results 20. Technical competency testing
Audit results	Financial statements	21. Frequency and impact of financial statement restatements for errors 22. Fraud and other financial reporting misconduct 23. Inferring audit quality from measures of financial reporting quality
	Internal control	24. Timely reporting of internal control weaknesses
	Going concern	25. Timely reporting of going concern issues
	Communications between auditors and audit committee	26. Results of independent surveys of audit committee members
	Enforcement and litigation	27. Trends in PCAOB and SEC enforcement proceedings 28. Trends in private litigation

Source PCAOB Release No 2015-5: 13

4.3 Samples of Audit Quality Indicators

4.3.1 Partner Workload

The "partner workload" indicator generates data about the level of work for which the audit engagement partner is responsible and the number of claims on his or her attention (PCAOB Release No 2015-5: A3).

Illustrative Calculations 1: Partner Workload

Engagement level	Firm level
a. Chargeable hours managed by audit engagement partner for all public and private clients for the current year (planned) and prior year (actual)	a. Average chargeable hours managed by public company audit engagement partners for all public and private clients for the current year (planned) and prior year (actual)

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Engagement level	Firm level
b. Number of public clients, and number of private clients, whose audits are managed by the audit engagement partner and audits for which that partner is a quality control reviewer, noting those with calendar year-ends, for the current year (planned) and prior year (actual)	b. Public company audit engagement partners' average utilization percentage for the current year (planned) and prior year (actual)
c. Audit engagement partner's utilization percentage for the current year (planned) and prior year (actual) (Utilization rate = Number of hours partners spent working for their public and private sector customers in a year/Total annual working hours of partners)	

Source PCAOB Release No 2015-5: A-3

Indicator expressed in Item "a" requires drawing up a representation of chargeable hours allocated to public and private sectors by audit firm's partner as of prior year and planned year.

Indicator 1. Indicator Regarding Partner Workload in Hours (Engagement Level Item -a-)

Partners	Prior Year		Total	Planned year		Total
	Public	Private sector		Public	Private sector	
Ahmet Ok	600	1.800	2.400	700	1.900	2.600
Mehmet uç	1.200	1.000	2.200	1.500	1.200	2.700
Hasan Yay	2000	500	2.500	1.800	800	2.600

Source Yükçü and Koçakoğlu (2017): 150

Audit firm will determine the possible deviations by comparing partners' planned working hours with actual working hours as of the current year's end.

Indicator 2. Deviation of Partners' Planned Working Hours and Actual Working Hours as of the Current Year (Engagement Level Item -a-)

Partners	Planned		Total	Actual				Total	Total deviation	Total percentage deviation
	Public	Private sector		Public	Deviation	Private sector	Deviation			
Ahmet Ok	700	1.900	2.600	780	+80	1.950	+50	2.730	+130	0.048
Mehmet Uç	1.500	1.200	2.700	1.600	+100	1.150	−50	2.750	+50	0.018
Hasan Yay	1.800	800	2.600	1.500	−300	900	+100	2.400	−200	0.083

Source Yükçü and Koçakoğlu (2017): 150

Such deviation analysis is a significant indicator that will aid in demonstrating partners' performance in public and private sectors. Similar indicator studies has the quality to aid in evaluating the performance of all audit personnel of a firm alongside the partners of the independent audit firm (Yükçü and Koçakoğlu 2017: 150).

Item "b" contains two phased information. In the first one, as an indicator, audit services that the partner provides for public and private sector as of prior and planned year in terms of firm count is required. This information can be composed as follows (Yükçü and Koçakoğlu 2017: 150).

Indicator 3. Indicator of Workload in Terms of Partners' Firm Count (Engagement Level Item -b-)

Partners	Prior year		Total	Planned year		Total
	Public sector	Private sector		Public sector	Private sector	
Ahmet Ok	2	6	8	2	7	9
Mehmet Uç	4	3	7	5	4	9
Hasan Yay	7	2	9	6	4	10

Source Yükçü and Koçakoğlu (2017): 150

In second phase, in the event that this partner, which provides audit services to public and private sector, provides those services not in audit activities but in reviewing audit quality, it is required that a new indicator chart regarding this is composed. According to this, in the next indicator, partner's services to auditees in reviewing audit quality is projected as follows (Yükçü and Koçakoğlu 2017: 151).

Indicator 4. Indicators on Service of Reviewing Audit Quality per Number of Firms Belonging to Partners (Engagement Level Item -b-)

Partners	Prior year		Total	Planned year		Total
	Public sector	Private sector		Public sector	Private sector	
Ahmet Ok	0	2	2	1	2	3
Mehmet Uç	1	1	2	1	1	2
Hasan Yay	2	0	2	2	2	4

Source Yükçü and Koçakoğlu (2017): 151

Aforementioned indicator charges independent audit partners with crucial duties regarding the review of audit quality alongside audit activities (Yükçü and Koçakoğlu 2017: 151).

Indicators that will be presented in Item "c", requires a ratio calculation and this ratio is called utilization rate. It is formulated as Utilization Rate = Chargeable Hours/Total Working Hours. Utilization rate aims to show how much time the personnel (partner, manager or audit personnel) allocates to audit activities, his/her main job, from his/her total working hours (Yükçü and Koçakoğlu 2017: 151).

Indicator 5. Utilization Rate Chart On Partner Basis (Engagement Level Item -c-)

Partners	Prior year		Ratio (1/2)	Planned year		Ratio (3/4)
	Total of chargeable hours (1)	Total working time (2)		Total of chargeable hours (3)	Total working time (4)	
Ahmet Ok	2.400	4.300	0.56	2.600	4.100	0.63
Mehmet Uç	2.200	4.200	0.52	2.700	4.400	0.61
Hasan Yay	2.500	4.100	0.61	2.600	4.500	0.58
Total	7.100	12.600		7.900	13.000	

Source Yükçü and Koçakoğlu (2017): 151

Aforementioned indicators are very useful in determining how much time (percentage) partners allocate to audit activities that create added value from their total working hours (Yükçü and Koçakoğlu 2017: 151).

Indicator 6. Deviation of Partners' Planned Utilization Rate as of Current Year and Actual Utilization Rate (Engagement Level Item -c-)

Partners	Planned		Ratio 1 (1/2)	Actual		Ratio 2 (3/4)	Deviation (Ratio 1 − Ratio 2)
	Total of chargeable hours (1)	Total working time (2)		Total of chargeable hours (3)	Total working time (4)		
Ahmet Ok	2.600	4.100	0.63	2.730	4.250	0.64	+0.01
Mehmet Uç	2.700	4.400	0.61	2.750	4.480	0.61	0
Hasan Yay	2.600	4.500	0.58	2.400	4.200	0.57	−0.01

Source Yükçü and Koçakoğlu (2017): 152

Such indicators are useful in revealing what percentage of the audit activities planned for partners can be actually realized by them (or other audit personnel) (Yükçü and Koçakoğlu 2017: 152).

4.3.2 Experience of Audit Personnel

This indicator measures the level of experience of members of a particular engagement team and the weighted average experience of firm personnel generally (PCAOB Release No 2015: A-6).

Illustrative Calculations 2: Experience of Audit Personnel

Engagement level	Firm level
For partners, managers, staff auditors, specialists, and engagement quality reviewers: a. Number of years on the engagement b. Number of years in present assignment and personnel level c. Number of years: (i) with the firm and (ii) in the auditing profession	a. Average experience for total audit personnel b. Weighted average years of experience for partners, managers, staff auditors, and specialists respectively

Source PCAOB Release No 2015: A-7

Sampling of Indicators on Engagement Level

In engagement level Item "a", assignment duration of partners, managers, auditors, specialists ve and audit quality reviewers is requested separately (Yükçü ve Koçakoğlu 2017: 169).

Indicator 7. Number of Years per Engagement in Current Levels of Audit Personnel (Engagement Level Item -a-)

Engagement name	Partners	Managers	Auditors	Specialists	Audit quality reviewers
Engagement 1	3	4	4	5	1
Engagement 2	2	3	1	1	1
Engagement 3	1	2	6	6	1
Engagement 4	4	1	8	4	2
Engagement 5	2	1	6	3	1
Engagement 6	1	2	6	4	1
Engagement 7	3	3	4	2	2
Engagement 8	3	2	1	3	1
Engagement 9	2	1	1	1	1

Source Yükçü and Koçakoğlu (2017): 169

In Item "b", it is requested that duration in the current assignment and total time spent on personnel level appear in indicator chart as an indicator. In Item C however, time spent on current firm and on the profession is requested separately. Information requested for both Item "b" and Item "c" is as follows (Yükçü and Koçakoğlu 2017: 171):

Indicator 8. Detailed Seniority of Audit Personnel (Engagement Level Item -b-c-)

Current level	Name/Surname	Current assignment	Years on current level	Years on current assignment	Years on the firm
Partners	Ahmet Ok	Global partner	26	8	28
	Mehmet Uç	Responsible partner lead auditor	20	6	12
	Hasan Yay	Responsible partner lead auditor	18	6	15
Managers	Ali Kara	Senior auditor	15	3	5
	Ayşe Kama	Senior auditor	15	3	4
	Sema Adıgüzel	Senior auditor	14	3	6
	Onur Başarır	Senior auditor	16	4	8
	Canan Yılmaz	Senior auditor	13	2	5

Source Yükçü and Koçakoğlu (2017): 171

Sampling of Indicators on Firm Level

Indicator 9. Average Experience of Entire Audit Personnel (Firm Level Item -a-)

Cumulative experience duration of entire audit personnel (1)	Number of total personnel (2)	Average duration of experience (1/2)
252 years	25	10.08 years/personnel

Source Yükçü and Koçakoğlu (2017): 172

Indicator 10. Weighted Average Experience Duration by Audit Personnel Level (Firm Level Item -b-)

Personnel level	Total work duration in auditing (1)	Personnel count (2)	Average (1/2)
Partners	71	3	23.7 years/partner
Managers	90	5	18 years/manager
Auditors	36	7	5.14 years/auditor
Specialists	20	4	5 years/specialist
Audit quality reviewer	35	6	5.8 years/audit quality reviewer

Source Yükçü and Koçakoğlu (2017): 172

Auditors with proper experience can approach both audit in general terms and audit of a specific customer in a wiser and more effective manner. But auditors who spent a lot of time in a specific audit team may start to lose their scepticism capacity as a consequence of gaining familiarity with affairs. At this point the necessity to maintain the balance between the advantage of an experienced audit team, participation of new auditors who will provide audit affairs with a fresh perspective and the customer arises. The data this indicator provides must be evaluated by taking the balance into consideration (PCAOB Release No 2015-5: A-7).

4.3.3 Audit Hours and Risk Areas

This indicator measures the time spent by members of the audit team at all levels on risk areas identified by the firm during audit planning (PCAOB Release No 2015-5: A-11).

Illustrative Calculations 3: Audit Hours and Risk Areas

Engagement level	Firm level
a. Total chargeable hours, and percentage of hours, by significant risk area for partners, managers, audit staff, technical accounting and auditing resource personnel, specialists, and the engagement quality reviewer, respectively, for the current year (planned) and the prior year (actual)	a. For audits by industry, computed separately, average chargeable hours overall and by significant risk area for partners, managers, audit staff, technical accounting and auditing resource personnel, specialists, and the engagement quality reviewers, respectively, for the prior year (actual)

Source PCAOB Release No 2015: A-11

At the Indicator 11. chart columns show partners, managers, audit personnel, technical accounting, specialists and audit quality reviewers.

Indicator 11. Ratio of Risky Area Audit to Total Audit Time (Prior Year) (Engagement Level Item -a-)

Engagements	Personnel title/Level												Total (hr.) (7)
	Partners		Managers		Audit personnel		Technical accounting		Specialists		Audit quality reviewers		
	Time (hr.) (1)	Ratio (1/7)	Time (hr.) (2)	Ratio (2/7)	Time (hr.) (3)	Ratio (3/7)	Time (hr.) (4)	Ratio (4/7)	Time (hr.) (5)	Ratio (5/7)	Time (hr.) (6)	Ratio (6/7)	
Eng. 1	50	**0.02**	180	**0.075**	300	**0.125**	100	**0.04**	100	**0.04**	100	**0.04**	2.400
Eng. 2	58	**0.02**	200	**0.07**	320	**0.11**	120	**0.04**	100	**0.04**	100	**0.04**	2.800
Eng. 3	70	**0.02**	250	**0.07**	350	**0.10**	120	**0.03**	140	**0.04**	150	**0.04**	3.600
Eng. 4	60	**0.02**	200	**0.07**	300	**0.11**	100	**0.04**	120	**0.04**	120	**0.04**	2.800
Eng. 5	70	**0.02**	240	**0.06**	350	**0.10**	120	**0.03**	150	**0.04**	135	**0.04**	3.600
…	…	…	…	…	…	…	…	…	…	…	…	…	…
Eng. n	80	**0.02**	270	**0.07**	400	**0.10**	170	**0.04**ara>	180	**0.05**	150	**0.04**	3.900

Source Yükçü and Koçakoğlu (2017): 181

Performing audit in risky areas with its specialists shows the importance attached to audit. Reporting this audit time as a separate "Planned Year" indicator is of vital importance (Yükçü and Koçakoğlu 2017: 181).

Indicator 12. Ratio of Risky Area Audit to Total Audit Time (Planned Year) (Engagement Level Item -a-)

	Personnel title/Level												Total (7)
	Partners		Managers		Audit personnel		Technical accounting		Specialists		Audit quality reviewers		
	Time (hr.) (1)	Ratio (1/7)	Time (hr.) (2)	Ratio (2/7)	Time (hr.) (3)	Ratio (3/7)	Time (hr.) (4)	Ratio (4/7)	Time (hr.) (5)	Ratio (5/7)	Time (hr.) (6)	Ratio (6/7)	
Eng. 1	55	**0.02**	190	**0.078**	300	**0.12**	90	**0.04**	100	**0.04**	110	**0.045**	2.450
Eng. 2	60	**0.02**	200	**0.07**	330	**0.12**	125	**0.04**	100	**0.035**	110	**0.039**	2.850
Eng. 3	60	**0.02**	250	**0.07**	370	**0.10**	115	**0.03**	140	**0.04**	160	**0.043**	3.680
Eng. 4	65	**0.02**	220	**0.08**	330	**0.12**	110	**0.04**	120	**0.04**	130	**0.046**	2.775
Eng. 5	72	**0.02**	245	**0.07**	380	**0.10**	115	**0.03**	150	**0.04**	150	**0.041**	3.650
…	…	…	…	…	…	…	…	…	…	…	…	…	…
Eng. n	84	**0.02**	270	**0.07**	400	**0.1**	175	**0.04**	180	**0.045**	160	**0.04**	4.000

Source Yükçü and Koçakoğlu (2017): 182

Measuring the hours that levels of an audit team devote to risk areas can suggest whether audit managers have staffed the audit appropriately to reflect the risk areas identified during the planning phase of the audit and the extent to which senior members of the team have focused sufficiently on those areas. Measuring hours that other engagement teams from the same audit firm devote to risk areas in audits of other public companies in the same industry as the engagement client may provide grounds for a greater understanding of the nature of the risks the firm identifies in audits of that industry, how it staffs to deal with them generally, and the degree of focus its audit teams give them. This is another situation in which context may be very important, different companies in the same industry may present different risks due to, for example, systems, people, or process issues at one or more of those companies (PCAOB Release No 2015: A-11).

4.3.4 *Frequency and Impact of Financial Statement Restatements for Errors*

This indicator measures the restatements for error of financial statements whose audit the audit firm has performed (PCAOB Release No 2015: A-19).

Illustrative Calculations 4: Frequency and Impact of Financial Statement Restatements for Errors

Engagement level	Firm level
a. Number and magnitude of audit practice's restatements for errors at engagement level, computed annually	a. Number and percentage (of audited financial statements) of an audit practice's restatements for errors, computed annually, and magnitude of those restatements b. The audit firm's top five annual restatements measured by the magnitude of those restatements

Source PCAOB Release No 2015: A-19

Independent audit firm prepares audit reports for every engagement. After the report is written up, Quality Risk Management Department selects and reviews some of the engagements to check whether the process is conducted with adequate quality. Following the review, in audits regarding some of the engagements, some changes in financial statements composed as a result of internal quality evaluation, may be necessary. These changes may occur as a result of increase or decrease in financial statement items. Change of financial statement items may cause a change in total distributable profit in a vast scale. Increase or decrease in distributable profit causes major or minor changes in financial statements (Yükçü and Koçakoğlu 2017: 210).

Engagement Level Item -a- contains the number and the magnitude of the corrections that cause changes in financial statements. An indicator chart regarding the subject can be composed as the following: (Yükçü and Koçakoğlu 2017: 210)

Indicator 13. Impact and Frequency of Financial Statements Restated Due to Error (Engagement Level Item -a-)

Engagement name	Number of financial statement changes	Magnitude of financial statement change	Type of financial statement change
Eng. 3	2	55.0	• Tangible assets change • Distributable profit change
Eng. 6	1	0 TL	• Postscript change
Eng. 8	3	18.0	• Assets to be sold • Distributable profit
Eng. 49	1	1.0	• Exchange loss
Eng. 51	1	1.200.0	• General administrative expenses, distributable profit
Eng. 52	2	2.892	• Interest expenses
Total	10	1.276.892 TL	

Source Yükçü and Koçakoğlu (2017): 211

Audit firm has prepared 52 audit engagements in total. 12 of these have been subjected to Internal Quality Evaluation by Risk Management Department. In 6 of these 12 engagements, changes that also entail changes in financial statement were made. These changes can be seen above as a chart. Percentage of changes on audit firm level is seen in the indicator chart (Yükçü and Koçakoğlu 2017: 211).

Indicator 14. Percentage of Financial Statements Restated Due to Error in Total Engagements and in Engagements Subject to Internal Control (Firm Level Item -a-)

Ratio	Calculation	Result
$\frac{\text{Number of Engagements With Altered Financial Statements}}{\text{Total Number of Engagements}}$	6/52	0.12
$\frac{\text{Number of Engagements With Altered Financial Statements}}{\text{Total Number of Engagements Subject to Internal Control}}$	6/12	0.5

Source Yükçü and Koçakoğlu (2017): 211

Indicator 15. First Five Engagements Regarding the Impact of Financial Statements Restated Due to Error (Firm Level Item -b-)

Engagements in descending order	Engagement name	Number of financial statement changes	Magnitude of financial statement change
1	Eng. 51	1	1.200.000 TL
2	Eng. 3	2	55.000 TL
3	Eng. 8	3	18.000 TL

(continued)

(continued)

Engagements in descending order	Engagement name	Number of financial statement changes	Magnitude of financial statement change
4	Eng. 52	1	2.892 TL
5	Eng. 49	1	1.000 TL
Total		8	1.276.892 TL

Source Yükçü and Koçakoğlu (2017): 212

The number and impact of restatements for errors (i.e., not for changes in accounting principles) are generally considered a signal criterion of potential difficulties in at least parts of an auditor's practice and approach to auditing. This indicator tries to place restatements in context by focusing on their magnitude. Magnitude of restatements could be measured in a number of ways, including impact of the restatement on income, on cash flows and balance sheet, and on market capitalization (PCAOB Release No 2015-5, App A-19).

4.4 Audıt Qualıty Indıcators wıth Regard to Our Country

4.4.1 Establishing Standards

When we look at the audit quality indicators with regard to our country, first thing to be done is establishing and publicating the standards on this subject. Regarding the establishment of standards, PCAOB has published many recommendations on audit quality indicators till now. Public oversight authority which sets the standards in our country has started to receive opinions of members of the profession on the subject through its official website.

Establishing standards will probably take time. Following the establishment of standards, public oversight authority will demand that independent audit firms abide by these standards. First step of abiding by the standards is the necessity of establishing a quality risk management department within independent audit firms.

Quality Risk Management Department

Independent audit firms in our country must first solve the problem of internal organization before establishing "Quality Risk Management Department".

There is a big difference between the organizing mechanism of independent audit firms known as big four in the world and the organizing mechanism of firms of our country. While the big four have a hierarchical structure that starts with joint lead auditor and extends to auditor assistant, independent audit firms of our country have an organizing mechanism based on one man. With one man organizing mechanism it is not possible to compete with big four even for the audit of the firms in our country let alone on global scale.

Besides, PCAOB's all indicator recommendations are made in accord with the organizing mechanism of the big four. Since the Public Oversight Accounting and Auditing Standards Authority (KGK) comprises the standards through the translation of English texts, our standards and audit quality indicators will also be in accordance with the organizing mechanism of big four.

Independent audit firms in our country will establish the Quality Risk Management Department by taking business capacity and company size in to consideration.

Quality Risk Management Department will create indicators in accordance with its own firm's organization by taking the standard KGK establishes on the subject into consideration. These indicators, from our point of view, will primarily function as drafts of independent audit engagements performed by the firm (in other words budgeted indicators). Draft indicators must be established at the beginning of fiscal year and include the ratios required by KGK standards. If we pay close attention, we see that draft indicators, in order to ensure target independent audit quality, requires performing the audit in durations that requires effort in order to reach. Independent Audit Firm will perform independent audit throughout a fiscal year and even beyond it in order to come up to these indicators. It must not be forgotten that indicators must be established for the entirety of the independent audit firm and also separately for each company with whom it has an engagement and also whom it will subject to audit.

4.4.2 Inspection of Audit Quality Indicators

Inspection of audit quality indicators must be examined in two parts:

1. Internal inspection in which Quality Risk Management Department inspects independent audit firm's own personnel.
2. Exterior inspection in which KGK inspects independent audit firms.

These can be examined separately, in brief, as follows:

4.4.2.1 Internal Inspection

Quality Risk Management Department of an independent audit firm, with the participation of firm personnel, must create drafts of audit quality indicators determined by KGK, for itself and each company with whom it has an engagement and whom it will subject to independent audit. These indicators must be shared with the public on electronic environment through the official website of the independent audit firm as a requirement of principles of transparency and accountability. Same indicators must be sent to KGK through the first months of the fiscal year (for example end of February) by the independent audit firm.

KGK must share the indicators sent by independent audit firms on electronic environment through its own official website, separately for each firm. Those shared indicators must be perceived as independent audit firm's commitment to public. KGK must check on what degree independent audit firms abide to this commitment. Checking process can be in the form of comparing draft indicators to actual indicators at the end of the fiscal year, as well as comparing quarterly or semiannual indicators.

4.4.2.2 External Inspection

KGK will collect independent audit firms' draft and year-end actual ratios and will question the causes of unfavorable variations as per the draft in relation to independent audit firms. Interim questioning will prevent inadequate independent audit activities that might occur within the period. For an external inspection of this size, KGK must organize in a substantial manner and audit quality of every engagement of independent audit firms must be inspectable through screening procedure with an adequate number of specialists. Otherwise other Enron cases will be unavoidable. KGK must enforce sanctions on independent audit firms in the event of an unfavorable deviation in audit quality indicators.

Examples of unfavorable deviation at this point are as follows:

a. Having worked with a utilization rate lower than expected.

Utilization rate is formulated as Chargeable Hours/Total Working Hours. Utilization rate aims to reveal how much time the personnel (partner, manager veya audit personnel) allocates to audit activities, his/her main job from his/her working time (Yükçü and Koçakoğlu 2017: 151).

b. Favorable or unfavorable variation in distributable profit base.

As a means of enforcement, depending on the significance of variations, penalties of admonition, fine and dismissal from the profession for a given period may be imposed on audit firms. These penalties imposed as a requirement of principle of transparency must be announced on KGK's and independent audit firm's website.

4.5 Conclusion

Even though audit quality indicators are an initiative started by American Public Oversight Board, PCAOB, such determinative indicators and mathematical ratios have been used for many years by both public oversight boards and members of the profession. PCAOB offers this existing but not systematically common effort to both investors and third parties benefiting from independent audit as a tool of information acquisition and inspection. The fact that internal dynamics of independent audit activity remain mostly as auditor's mission decreases the authority of third parties benefiting from audit, on the process. The fact that most of the audit quality indicators designed so as to provide numerical content will add objectivity to future evaluations.

Independent audit authorities in Turkey and Public Oversight, Accounting and Auditing Standards Authority- KGK must also be a part of this. At this point, primary requirement is to establish a standard. This step must be followed by independent audit firms' establishment of "Quality Risk Management Department" just as the big four did. This department, at the beginning of the period, must create draft indicators for independent audit firm's entirety and for every engagement it undertakes and must be held responsible for submitting them to KGK on electronic environment. Draft indicators finalized as of the year-end and prior ones must be shared with public as a requirement of the principles of transparency and accountability, must be inspected by KGK and if there are unfavorable variations, the causes must be questioned.

Aim of this study is determined as to bring forward suggestions on introduction, inspection on electronic environment and public disclosure of audit quality indicators and this goal is mostly achieved.

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General Accounting
Management Accounting
Solved Cost and Management Accounting Problems
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Chapter 5
Decoding Corporate Governance and Insolvency Related Issues in India

Anant Vijay Maria and Kanwal D. P. Singh

Abstract Corporate governance principles were incorporated after the financial impropriety of the owners/managers increased at a rampant stage whereby innocent stakeholders were left without a remedy. The governance structure and distribution of rights of different participants in the corporation and their equally accountable duties were necessary in the modern corporation to prevent siphoning of funds or oppression and mismanagement. Post Ketan Parekh and Satyam Scams, India has come to more intricate questions of Cyrus Mistry where the law is unable to demystify the complex board structures and lack of transparency and accountability in such corporate structures. The exploitation comes to the forefront when the company is in financial distress and is being led towards insolvency. The Promoters/Board members generally try to maximize profits and bonus payments even in the eventualities of distress. At the time of scrutiny before adjudicatory authority in process of declaration of insolvency the problems come to the forefront and increase manifold. Group structures, shareholder responsibilities, payment of dividends and director duties are some of the key problems that have taken the shape of big corporate issues. This leads to corporate governance issues, which the business world is tackling for long. OECD in 2014 has laid down G20 principles to promote best practices in the world. The authors in this paper will analyze these key principles and issues in corporate governance as enunciated by OECD and IOSCO. The authors also propose to scrutinize various cases of insolvency passed in the Indian jurisdiction which entrench on corporate governance practice. The paper will also argue the role of directors and promoters bidding during resolution process and its impact on insolvency proceedings. It is proposed to suggest various measures to improve the status quo to make corporate governance and insolvency as stable as possible to increase the investor sentiment and economic development of the country.

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Corporate governance has been defined as "system of rule, practices and process by which a firm is directed and controlled, corporate governance essentially entails balancing interest of the company, the stakeholders, such as shareholders, management, customers, suppliers, financers, government and the community (Hans 2015). Since corporate governance provides the framework for attaining company's objectives, it is encompassing practically every sphere of management from action plans and internal controls to performance management and corporate disclosure. There are several management theories on Corporate Governance such as Agency Theories, Stewardship Theories, Resource Dependence theories, Stakeholder theories (Haslinda and Benedict 2009). Famous Cadbury Committee Report (Cadbury 1992) defined corporate governance as, "Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting."

The practice of corporate governance existed in almost a non-existing stage and was mostly self-imposing voluntary guidelines in India. The first initiative that can be traced to be undertaken was by Confederation of Indian Industry (CII), which gave a voluntary code of corporate governance in the year 1998 (Asian Corporate Governance Association 1998). However, it was the Kumar Mangalam Birla committee set up by SEBI[1] (Birla 1999) that brought up the standards of good governance in its report, it included emphasis on independent directors and board recommendations, which were regarding their representation and independence. These recommendations were incorporated into Clause 49 of the Listing Agreements of the Stock Exchanges (SEBI 2000). The next initiative was by the Naresh Chandra committee appointed in 2002 (Chandra 2002) by Department of Company affairs and made recommendations to the effect of financial and non-financial disclosure and independent auditing and board oversight of management. SEBI under the chairmanship of Mr. Narayan Murthy set up a committee to examine Clause 49 and to suggest improvements in corporate governance standards. The committee strengthened the definition of director's independence in the then pre-existing Clause 49. These committees were influenced by UK and US committee report of Cadbury (Report of the Committee on the Financial Aspects of Corporate Governance 1992) and Blue Ribbon Committee (Millstein 1999) respectively. Under the aegis of Dr. J.J. Irani a comprehensive Expert committee was set up to provide for a new Companies Bill which was later introduced as Companies Bill, 2008 on the recommendation of

[1]The Securities and Exchange Board of India.

Irani Committee. However, due to dissolution of 14th Lok Sabha, Companies Bill, 2008 lapsed and was later introduced as Companies Bill, 2009.

In early 2009, India corporate world was rocked by Satyam Computer Scam which was a massive accounting fraud in India and was also called by some as Enron of India. It made the Ministry of Corporate Affairs (MCA) and the Securities and Exchange Board of India (SEBI) conduct immediate investigations and arrest promoters, insiders and auditors of Satyam (Varottil 2010). The government substituted the company's director with government nominee as an interim measure. This led to bigger question of corporate failure which points back to corporate governance standards. The failure of such norms allowed massive scandal to happen in the first place. The re-assessment of Corporate Governance standards was conducted pan industry to suggest concrete solutions to avoid such a scam. The MCA, in late 2009 considering several suggestions from NASSCOM (Sharma 2009), CII and ICSI[2] released a set of voluntary guidelines for corporate governance (Ministry of Corporate Affairs 2009), the guidelines were mechanism to encourage whistle blowers, auditors and secretarial audits also responsibilities of the board and its independence per se.

5.1 Satyam Scam and Corporate Failure

Satyam-Maytas Fraud case involved Ramalinga Raju[3] and his family who had siphoned of Rs 2,743 crore from the company wherein cash reserves were inflated, liability was understated and promoters had floated front companies to park the siphoned money. The front companies also issued unaccounted loans worth Rs 1500 crores. Price Waterhouse had failed in its auditor's role while the non-executive directors were paid Rs. 72 lakh as commissions. The Maytas takeover to hide the scam was treated as failure on part of corporate governance and SFIO[4] to prevent such scrupulous practices (Ramachandraiah 2009) In 2015, Ramalinga Raju was convicted by special court, CBI.[5] Price Waterhouse is till date facing prosecution and charges in the Supreme Court of India in the case Chintalapati Srinivasa Raju V/s Securities and Exchange Board of India. The Satyam company had to be latter auctioned under the Companies Act, 1956 and the 46% stake in Satyam was purchased by Mahindra and Mahindra and was called as Mahindra Satyam (Teltumbde 2010). This company however, became defunct in 2013 as it was merged with Tech Mahindra on 11 June 2013 as per approval of the Andhra Pradesh High Court. Entire case of Satyam scandal depicts the need of tougher corporate governance norms in order to promote better business practices and to avoid scrupulous malpractices by promoters and directors to push the company towards insolvency.

[2]Institute of Company Secretaries of India.

[3]Promoter of the company.

[4]Serious Fraud Investigation Office constituted under the Companies Act.

[5]Central Bureau of Investigation.

5.2 The Companies Act, 2013 and LODR Guidelines

The final recorded approval to codified corporate governance norms were introduced in the form of provision in Companies Act, 2013 (Kaur 2016) where in independent directors, CSR, women directors and mandatory secretarial compliance was introduced the Companies Act, 2013. Independent directors' composition was significantly increased to 1/3rd of total number of directors and public companies to have two or more directors for paid up capital unto 100 crores (The Companies Act, 2013). As per section 177 of the Companies Act, 2013 and Rule 6 and 7 of Companies (Meetings of Board and its Powers) Rules, 2014 dealing with the audit committee, the audit committee under the new Act for both private and public companies need to comprise of three independent directors along with chairperson who are able to understand the financial statements.

Clause 49 was brought in compliance with the Companies Act through 2014 amendment (SEBI 2014) wherein SEBI amended the norms and imposed stricter norms on listed companies. Related party transactions, non-applicability to mutual funds and monitoring of the compliance by SEBI monitoring cell were few important conditions that were imposed by SEBI as per the powers vested by SEBI Act under S. 11 read with Section 11A of SEBI Act.

SEBI further notified SEBI-Listing Obligations and Disclosure Requirements (LODR), 2015 which came into force on 1 December, 2015 to replace existing clause 49 of listing agreement. The change brought greater statutory compliance instead of Clause 49 requirements. LODR guidelines (Madhavan and Kastubh 2016) contained substantive and procedural part to maintain strict corporate governance norms in a listed company and the new regulation brought India in compliance with OECD guidelines (OECD 2015) and IOSCO principles (IOSCO 2016) The dispute between corporate governance got its share of limelight during Tata Sons and Cyrus Mistry group fight.

5.3 Dispute Between Tata Sons and Cyrus Mistry

On 24.10.2016, Tata Sons Ltd. held board meeting where Mr. Cyrus Mistry was removed from the position of Chairman of the company under the agenda "any other item", wherein he was not given the mandatory 15 days' notice as prescribed. This triggered a petition to NCLT for oppression and mismanagement wherein Mr. Tata and Mr. Soonawala were alleged to misuse the Articles of Association and removal of him as chairman was tip of the iceberg. Misuse of articles of association became one of the grounds to show impediment to the corporate governance of the company. Tata Trust was alleged to interfere in day-to-day affairs of the company and Mr. Cyrus Mistry tried to operate the functions of the two companies to maintain corporate governance. National Company Law Tribunal (NCLT) Bench comprising of Hon'ble Mr. B.S.V. Prakash Kumar and Mr. V. Nallasenapathy stated in their opinion, "The petitioners' counsel tried to hypothesize a concept as if corporate governance has brought in to end corporate democracy, it is not so, because corporate democracy is genesis, corporate governance is species, so even in a fit of imagination also it will never contemplate corporate governance is set against corporate democracy, indeed it has come for strengthening corporate democracy - to streamline rule of democracy, not to stamp out rule of democracy".[6] Further "Basic idea of the corporate governance is to have transparency, accountability and fairness. Has it been said anywhere that so and so thing happened in the company is devoid of transparency? Moreover, this argument of Corporate Governance is in fact applicable against Mr. Cyrus because he is the person continued in the management." Hon'ble NCLT held against Cyrus Mistry on the allegation of non-observance of corporate governance. This decision is a key decision to decode the judicial interpretation of the Companies Act, 2013 and the court's interpretation on corporate democracy or majority rule is genesis and corporate governance is a species.

5.4 Uday Kotak Committee Report

SEBI constituted a 21-member committee on corporate governance to be headed by Mr. Uday Kotak, a lead banker in India in June 2017. The committee in its suggestions provided for a major overhaul for listed companies and their compliance of corporate governance norms. The Committee recommended several key reforms such as separation of the roles of Chairperson and MD/CEO, monitoring of group entity, minimum board strength, independent directors, shareholder meeting and cash flow statement, and minimum remuneration and risk management. SEBI on March 28, 2018 accepted 40 out of the 80 recommendations suggested by the committee.

Following were the key recommendation (Kotak Report, 2017):

- Reduction in the maximum number of listed entity directorships from 10 to 8 by April 01, 2019 and to 7 by April 1, 2020.
- Expanding the eligibility criteria for independent directors.
- Enhanced role of the Audit Committee, Nomination and Remuneration Committee and Risk Management Committee.
- Disclosures of auditor credentials, audit fee, reasons for resignation of auditors, etc.
- Disclosure of expertise of directors.
- enhanced disclosure of related party transactions (RPTs) and related parties to be permitted to vote against RPTs.
- Mandatory disclosure of consolidated quarterly results with effect from FY 2019-20.
- Enhanced obligations on the listed entities with respect to subsidiaries.

[6] Cyrus Mistry v Tata Sons.

5.5 Lehman Brothers Insolvency: A Case of Corporate Governance Failure

Lehman brother bank was a key casualty of Financial Crisis in US of 2008. The main areas that were identified as weaknesses were board of directors, corporate risk management, remuneration scheme and nomination committees. The two main causes of failure are "REPO 105" (Lehman Brothers Holdings Inc. Chapter 11 Proceedings Examiner's Report, 2010) operation what was the key "creative accounting" manoeuvre created by Lehman Brothers. According to the OECD principles, the corporate governance should "ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders". Based on these principles, board members supposed to act on a fully informed basis, in best interest and fairly to the company and shareholders. They should apply high ethical standards and should be able to exercise objective independent judgment on corporate affairs. Moreover, they are supposed to fulfill several functions including reviewing and guiding corporate strategy, risk policy budgets and business plans. The Board should also monitor the effectiveness and manage potential conflicts of interest as well as oversee the process of disclosure. Lehman Brothers' Board of Directors was composed of ten members. The Chairman and CEO was Richard S. Fuld, Jr. and included eight independent directors according to NYSE. However, behind all of that there was a fact that nine out of 10 directors were retired. Moreover, their average age were 68.4 years (four of them were over 75 years), only two of them have direct experience in financial service industry and only one of them had current financial sector knowledge. In addition, one was U.S. Navy officer, another theatrical producer. Pointless is also the fact, that indeed board members should be independent and suppose to take care of the corporation, they cannot do it very precisely. Especially not, when they are for instance, director of Weight Watchers International, as well as chairman of Lehman's governance and nominating committee and a member of the compensation, finance and risk committee at the same time (e.g. Marsha Johnsons Evans). At the end, Lehman Brothers board members were paid for their services extremely well, since the range was from \$325 000 to \$397 000 plus very high every year bonuses. However, this hasn't been enough to Mr. Fuld who rewarded himself with nearly half a billion dollars between 1993 and 2007.

Valukas report[7] (Lehman Brothers Holdings Inc. Chapter 11 Proceedings Examiner's Report, 2010) further stipulates that there is evidence that top officers of Lehman Brothers Company (including the Chief Executive) violated their duties by exposing the company to potential liability by filling misleading reports and financial statements. The specialty of Lehman Brothers misleading transactions was "Repo 105" through which company could remove billions of liabilities off the balance sheet. The existence and misuse of the "Repo 105" is very questionable and goes

[7]The report composed by court-appointed investigator of bankruptcy of Lehman Brothers, Anton Valukas.

beyond corporate governance, concerning from accounting to legal issues of its use. OECD norms become handy to define the precarious situation.

OECD Principles of Corporate Governance, 2004 specifically states that the corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders; That timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company; That an annual audit is conducted by an independent, competent and qualified auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respect.

The financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements (Fairfax 2010). When they were put to a test, corporate governance routines did not serve their purpose to safeguard against excessive risk taking in a number of financial services companies (Cheffins 2015). A number of weaknesses have been apparent. The risk management systems have failed in many cases due to corporate governance procedures rather than the inadequacy of computer models alone: information about exposures in a number of cases did not reach the board and even senior levels of management, while risk management was often activity rather than enterprise-based. These are Board responsibilities. In other cases, boards had approved strategy but then did not establish suitable metrics to monitor its implementation (Skeel 2011). Company disclosures about foreseeable risk factors and about the systems in place for monitoring and managing risk have also left a lot to be desired even though this is a key element of the Principles. Accounting standards and regulatory requirements have also proved insufficient in some areas leading the relevant standard setters to undertake a review. Last but not least, remuneration systems have in a number of cases not been closely related to the strategy and risk appetite of the company and its longer-term interests (Kirkpatrick 2009).

5.6 Insolvency and Bankruptcy in India

The Ministry of Finance under the chairmanship of Dr. TK Viswanathan set up Bankruptcy Law Reform Committee having the mandate to suggest overhauling of the insolvency and liquidation proceedings in India while also suggesting a comprehensive code to ease the process. The committee suggested major overhaul by submitting their report in November, 2015[8] whereby a class of creditors were created in order of payment followed by what they suggested India to move from debtor in possession to creditor in possession by formation of a new body to be called as Insolvency Resolution Professional. The report also suggested establishing an insolvency

[8]The report of the Bankruptcy Law Reforms Committee, Volume, 2015.

regulator known as Insolvency and Bankruptcy Board of India (IBBI), to establish an insolvency adjudicating authority, to regulate insolvency professionals and to form financial information utilities. This process was also initiated to improve India's ranking in Doing Business Report of World Bank where India was positioned at a substantially lower rank due to delayed recovery and also substantial loss in the amount of recovery due to the time taken. The following report was presented to parliament, who then formed a joined committee and subsequently the report was submitted on 28th April 2016 as the Report of The Joint Committee on The Insolvency and Bankruptcy Code, 2015. The recommendations of the committee were noted and the Insolvency and Bankruptcy Code, 2015 (IBC 2015) was introduced in Lok Sabha on 5 May 2016 and the same was promulgated after assent from both house and the President on 28th May 2016.

The Code became effective from May 2016 with object to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India (Khandge and Joshi 2017). The legislative progress that was being made in order to increase transparency and accountability was met with IBC, 2016 as a welcome change since a financially distressed firm can no longer dupe innocent investors and stakeholders. The corporate governance issue was enforced in a better manner as Financial creditors had more power to enforce their admitted debt from companies who were duping their stakeholders but could no longer do so as the action would be immediately taken by financial creditors. Lack of corporate governance in past has also displayed financial distress leading to insolvency and even financial crisis (Tiwari 2018).

The first ten cases for which resolution plans were approved, financial creditors recovered Rs 1,854.40 crore out of total claim of Rs. 5,530 crore that amounts to 33.53% of total claims outstanding has been recovered. The 12 companies notified by RBI for huge corporate debt are resolved by IBC to recover money and remove NPA's. 11 company cases were admitted; however, the resolution plan is yet to be finalised for any. The lowest rate of recovery was 6% as seen in Synergies Doorey Automotive Co. where the financial creditors could only recover Rs 54.7 crore out of the total claims of Rs 972.2 Crores (Economic Survey India 2017).

5.7 Synergies Dooray Automotive Case

Major corporate governance concerns were raised in the case of Synergies Dooray Automotive. It leased its primary assets to SPV[9] with the name of going concern as Synergies Casting, whereby the landers assigned their debt to the SPV. The

[9]Special Purpose Vehicle.

malfeasance was achieved as before applying under Sick Industrial Companies Act, the debt from SPV was transferred to Millennium Finance an NBFC which was objected by Edelweiss Asset Reconstruction Company. Edelweiss Asset Reconstruction company objected to the insolvency case that the transfer was done with malafide intentions of increasing the voting power in the committee of creditors and thereby incurring loss to other creditors. Primary contention was that since the Synergies casting was SPV of Dooray and hence, a related party in the eyes of law. The related party transactions are seen as a clear breach in Corporate Governance norms. However, this was of no avail as NCLT dismissed the petition and approved the resolution plan of Edelweiss as it met all legal parameters. The larger question, which became a mainframe debate, was whether NCLT has opened a loophole for flouting Corporate Governance and saving their companies furthermore? The level of scrutiny was abysmally low and thereby pointing a glaring defect in IBC, 2016.

5.8 Insolvency and Bankruptcy Amendment

S.5 (25) permitted anyone to be a 'resolution applicant' under the law. The government in order to prevent growing corporate governance concerns promulgated an ordinance vide Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017. The ordinance was aimed at debarring certain promoters who were entering into unscrupulous acts to regain control over the distressed company again. The Ordinance was introduced in November 2017 to make certain persons ineligible to be a 'resolution applicant' under the law. This led to a wide spread debate and confusion due to introduction of Section 29A of the Insolvency and Bankruptcy Code (Amendment) Act, 2017. Section 29A (a)–(i) bars eight categories of people from being a resolution applicant and submission resolution bids, which are:

(1) Undischarged Insolvent
(2) Convicted person with a sentence of imprisonment for two or more years
(3) Person having Non Performing Assets (NPA) from loan for one year or more
(4) Willful Defaulters
(5) Persons ineligible from dealing in the securities market by SEBI
(6) Persons disqualified as directors under the law
(7) Persons from foreign jurisdiction
(8) Corporate guarantee furnished in respect of Corporate Debtor under IBC.

The above-mentioned categories can neither bid nor be a resolution applicant and also cannot be associated with the debtor while the resolution plan is being assessed and implemented. The ordinance is criticized as the above eight categories are barred and with well- established reasons, but it also bars all connected persons with the categories.

The IBC, 2016 provides a wide web for the term 'connected person' as it is ambiguous to the extent of its inclusion of several categories of person which are promoters, holding and subsidiary companies, associate companies, persons in management, persons in control as well as related parties. The above shows the wide coverage the clause provides for making it tough to have enough eligible bidders under the law. Further, the term "related party" for the purpose of Code to be considered eligible bidders has been defined in three places with different coverage. The triangular description compromises of S. 188 of the Companies Act, 2013; Clause 49 of the listing agreement; S.2 (24) of the IBC itself where related parties qua corporate debtor is defined. This creates a conundrum regarding related party definition under IBC as such varying definition only complicates corporate governance norms and its compliance.

The amended section 29 A by the IBC (Amendment) Act, 2018 fails to appreciate that not all forms of business failures are per se fraud or mismanagement qua promoters as sometimes unfavorable business cycles happen which are out of control for any company. The case for rehabilitation or second chance will be hindered due to this amendment due to wide net section 29A bars from.

5.9 Case Study of Essar Steel and Bhushan Steel

The two companies figure in the top 12 accounts notified by RBI to proceed with Insolvency proceedings, however, the fact to be observed is that Indian Government notified mining ban pan India. India's Iron ore shipment got reduced to a mere 18 million tonnes in 2012. This substantially affected the steel companies and started producing further debt trap. Bhushan steel suffered a double blow on account of deallocation of Patrapara block in 2012, which got worse due to cheap imports from countries like China and Japan which downsized the market for Bhushan Steel. Furthermore, the assurance given by the government of coal and steel supply was also scuttled leading to bad turnover and growth for the company.

Essar steel as their pre-allowed gas supply was stopped in 2011 was already marred by their expansion plan on the basis of bank funding. Cheap Chinese import and price crash also forced them into economic downward spiral. The group eventually started to report failure and loses. The crux being that macroeconomic environment did not support economic growth leading to massive downfall. In 2019, an investigation by the Serious Fraud Investigation Office (SFIO), has finally filed the charge sheet which revealed the exact extent of involvement between the promoters of Bhushan Steel namely, Brij Bhushan Singal and Neeraj Singal who used various illegal methods to obtain bank loans between 2013 and 2017 amounting to Rs 45,800 Crore. The Court further identified nexus with former CFO Nittin Johari of siphoning off funds from Bhushan Steel and Bhushan Energy. The investigation reveals that funds were siphoned off through a web of 157 companies, which were directly or indirectly controlled by the Singals. These concerns were objected and raised by JSW, the resolution applicant who had won the bid. The main contention was asking for some protection from such future claims otherwise making the bid futile. Such flagrant violations are what undermines the entire resolution and insolvency process.

Essar steel was before NCLT for the purpose of insolvency proceeding whereby Numetal and Arcelor Mittal turned out to be the two leading resolution applicants. However, NCLT Ahmedabad rejected the applications due to ineligibility as per I.A. No. 98.2018 and I.A. No. 111 of 2018 vide order-dated 19.04.2018. The parties challenged the impugned order challenging disqualification under Section 29A of the above-mentioned applicants. ArcelorMittal was shown as co-promoter of Uttam Galwa as on 07.02.2018 and Uttam Galwa has been classified as NPA for more than one year although Arcerlor Mittal had de-invested in the company. Mr. Rewant Ruia has 25% share in Numetal, managing and controlling through Prisma Trust. The allegation being Mr. Rewant Ruia was deemed to be acting in concert with Mr. Ravi Ruia, the promoter of Essar and he being the personal guarantor, benefit from the transaction between Essar with SBI and hence was in violation of Section 29A. In order to make them eligible ArcelorMittal gave an escrow account amounting to Rs. 7,000 crore to clear Uttam Galva Dues which was the reason for his inelgibility. NCLAT had however reserved the judgment regarding the eligibility of resolution bid. The Supreme Court, held in favour of ArcelorMittal as his was a curable defect and made the party eligible to bid again as it had cleared Uttam Galva dues. Decision settled the position on ineligibility by and large and clarified the legislative intent also.

5.10 Report of the Insolvency Committee, 2018

The insolvency law committee was constituted in March, 2018.[10] One of the main agenda before it was streamlining the application of section 29A whereby only fraudulent people were prohibited from bidding in the insolvency resolution process. The committee recommended deletion of ‘person acting jointly or in concert with such person’ which was similar to SEBI Takeover Code, 2011. Further, pure financial entities were also excluded from Section 29A. Clauses (d) and (e) of Section 29A were relating to conviction for offence punishable more than two years and director’s disqualification. The ambit of the two clauses is that it is in nature of personal offences and thus should not be extended to the parties at large. It was thus, also suggested to put a list of scheduled offences to bar certain class of offences only.

The committee also recommended as a requirement of eligibility to state the same by the way of tendering an affidavit with the application wherein it shall provide that the resolution applicant is is eligible under law as per the requirement of Section 30(2)(e) of Insolvency and Bankruptcy Code, 2016. This recommendation of the committee is prospective in nature in order to preserve the sanctity of the resolution plan, which are in advanced stage. The same was observed in the case of RBL Bank Limited v MBL Infrastructure (CA (IB) No. 543/KB/2017 dated 18th December 2017), wherein NCLT Kolkata Bench held that the resolution applicant had his plan approved by Committee of Creditors (CoC), however, before it could be

[10]Report of the Insolvency Law Committee (2018).

implemented government promulgated the IBC Ordinance, 2016 thereby prohibiting the applicant under clause (c) and (h) of Section 29A as he was a corporate guarantor against whom the guarantee was not invoked. Kolkata Bench decided in favour of the resolution applicant, as the intention of the ordinance was not to prohibit innocent eligible class of person, while leaving the final decision to Committee of Creditors to approve the resolution plan.

Further, the problem of corporate governance and IBC has been growing with several cases being reported to SFIO for the purpose of siphoning off funds by the promoters and the consequential impact. The mechanism of avoidance proceedings has not worked to avoid preferential, extortionate, fraudulent or unlawful transactions. Amongst the twelve accounts referred by RBI, 8 such transactions have been referred for the purpose of fraudulent transaction. One such primary instance is that of IDBI Bank Ltd. v. Jaypee Infratech Ltd (CA No.26/2018 in Company Petition No. (IB)77/AD/2017), in which the NCLT Allahabad Bench has held that certain mortgages created by Jaypee Infratech Ltd. were in the favour of its lenders of the holding company- Jaiprakash Associates Ltd. This was considered amounting to preferential, undervalued and fraudulent transactions under the IBC, 2016. The NCLT reversed these transactions and ordered the lenders of Jai Prakash Associates to release and discharge the security interest created through the mortgages.

The recommendations of the committee basically circle on the fact that scrupulous promoters who flout corporate governance rules should not be rewarded their company at discount while causing financial distress to the creditors and economy at large. The 2018 ordinance promulgated also helped the MSME sector by reducing the case of ineligibility to disqualify willful defaulters only. In Wig Associates Case (C.P. No 1214/I&BC/NCLT/MB/MAH/2017 dated 04.06.2018.) of NCLT Bombay bench, CoC approved applicant's plan with 100% vote. However, the question of law arose whether the applicant is prohibited due to his relation to the Promoter Directors of the Corporate Debtor Company? The fact that he is a guarantor of the corporate debtor cannot be looked into as the Ordinance is to be construed as prospective in nature and not retrospective. This order got severely criticised by the government and financial institutions on the ground that it was anti-thesis to the aim of the 2018 Ordinance.

5.11 Pre-pack Pool

In 2014, United Kingdom came out with Graham Review into pre-pack administration which proposed to introduce pre-pack pools to promote better accountability and transparency when the assets of corporate debtor are sought to be bought by the promoter and its related/connected party. Pre-pack pool essentially is a pre handling of selling the assets of the company to the promoters though in secrecy. SIP 16 or statement of Insolvency practices 16 (SIP 16, 2015) tasks the duty of IRP to ensure transparency in the process. The obvious rationale is that sometimes promoters or connected person is the best possible combo for greater recovery to creditors and the presentation of the plan before pool of experienced businessmen established by the Board to undertake an independent scrutiny. According to the statement of insolvency practice issued, IRP can then process the bid or either declares the bid ineligible.

Moreover, India can take a similar approach to differentiate between innocent and unscrupulous promoters, a body like the pre-pack pool in the United Kingdom could be established. This would essentially entail the establishment of a body of experienced business Professional appointed by the Insolvency and Bankruptcy Board of India who could independently review promoter or connected party purchases. Promoter inclusion is also imperative because their complete exclusion dissuades them from cooperating with the resolution professional that requires relevant information from them to invite bidders. Lastly, exclusion is dangerous by virtue of the possibility of the promoter indulging in asset stripping and other high-risk behavior if the company is undergoing recurring losses and is on the brink of insolvency. Thus, promoters who have not indulged in any malfeasance must be given the opportunity to bid for their own companies.

5.12 Conclusion

Corporate governance is required to maintain check and balances in a company while promoting economic growth and development. World has witnessed time and again the consequences of failure in corporate governance compliance and leading to frauds such as Enron, Satyam etc., where the innocent investors are duped. The fraudulent practices with malafide intentions of promoters and directors have caused enough harm for Independent directors to clear. The burden of observance of corporate governance norms is necessary as the greed showcased by Lehman Brother's etc. evidenced that it can lead to downsizing of economy and even lead to Financial crisis.

The insolvency of Lehman Bros. was great evidence to the world that incase of uncontrolled and non-observing corporate accountability has disastrous impact. India also has had its own share of failure of the then Corporate Governance norms. Listed companies are under strict compliance and for observance as the impact on innocent investors and economy is massive. India introduced Insolvency and Bankruptcy Code, 2016 with the intention that the government will able to release the Non-Performing assets through recovery or rehabilitating the company for payment of financial institutions.

The early trend that was observed was promoters trying to influence the committee of creditors to buy back their companies at discount. This was a glaring error on part of legislation, as promoters would openly flout governance norms and siphon off the money only to recover it from creditors at discount. Therefore, government introduced S.29A of Insolvency and Bankruptcy Code, 2016 that introduced eight category of people who are per se ineligible to bid as a resolution applicant. This introduced the concept that promoters either through connected or related party can no longer bid as applicant thereby increasing the corporate governance compliance in India. The amendment, however, has not brought desired consequence as several litigations have challenged its constitutionality on account of its procedural validity and economic impact. The closure of innocent promoters buying back their companies has been looked down upon specially in a country like India where most of the companies are family owned groups and sometimes the business cycle being so that there is no moral hazard argument there. Resolution Professional needs to look into concerns of fraudulent transactions properly in order to address the issue of corporate governance and the malfeasance or fraud they have conducted which may have made the company come to the insolvency stage.

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Part II
Governance

Chapter 6
Conceptualizing Citizens Involvement in Governance

Kamna Sagar

Abstract Developing urbanization in India has supported the nation's economy as well as displayed complex administration challenges that should be set out to saddle monetary open doors related with urbanization. One of such difficulties is decentralized urban administration where residents need to have a stake in settling on how urban areas ought to be overseen. Encounters ensnare that in the perspective of developing urbanization in the nation, the structures of subject cooperation gave under the 74th Amendment Act, 1992 of the Constitution are bombing in protecting compelling resident investment. The paper accordingly requires a reexamining in such manner, and talks about encounters of effective resident interest in urban administration and learning of such encounters. A state's responsibility to its natives for open administration conveyance constitutes a focal segment of the democratic political entity. Yet, how to guarantee this responsibility? The appropriate response lies in the linkage amongst residents and some blend of chose political leaders and those they direct to give the administrations. This paper going to find out some answer such as why a few governments are steadier, proficient, imaginative also, all around oversaw than others. It finds the appropriate response in the move of worldview from an administration demonstrate in which natives were for the most part uninvolved to one in which they are given power and roads to impact open issues that influence their individual and their life. Citizen organization, as the new approach is famously known, depends on the possibility of dynamic citizenship and the way it influences the association and control of open administrations in our networks. it expands on the current social capital in networks to make residents refined shoppers of legislative issues, ones who connect with the administration in light of their identity and what their requirements are and not founded in transit government is composed. The interaction between social capital, exemplified in numerous grassroots and additionally corporate associations, and it holds colossal potential for upgrading citizens' participatory part in administration.

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Keywords Administration · Citizenship · Constitution · Democratic · Developing urbanisation · Governance · Nation economy

6.1 Introduction

The system of dynamic citizenship and its suggestions for the way we arrange and control open administrations for and inside our networks(groups), is both a subject of expanding significance to the natives and also a wonder of ever-more prominent significance in political and social life in India. The part of people in general in molding networks without bounds has for some time been underscored in dialogs on the 'great administration' worldview. Administration and Citizenship are two major mainstays of a popular government that empower the law-based framework to work with better capacity and productivity. Administration alludes to the type of the political framework what's more, the way in which control is practiced in using the nation's monetary and social assets for improvement (Moore 1995; 39).

The communication of citizens with the administration satisfies two essential requirements to make a popular government fruitful. One, it puts an arrangement of 'balanced governance on the administration, which guarantees that the legislature maintains a strategic distance from rehearses which obliterate the goodness of the majority rule government. Second, it satisfies a basic prerequisite of a political framework to be regarded a majority rules system, that is, individuals' support.

The role of citizens consolidating in administration has been simply the supporter of self-government. The idea of citizen's involvement into governance speaks to the quintessential thought of majority rule government. India is the world's biggest popular government and, by near gauges, a well-working one at that. India's law-based understanding till now has learned that great administration should essentially go for a development of social openings and evacuation of destitution. Administration must go for anchoring equity, straightforwardness and responsibility, strengthening, business and effective conveyance of administrations. The Indian State does not have imposing business model over people in general circle and the common society is progressively more worried about the general population circle while considering mediation of government basic for arrangement of welfare plans to cover social wellbeing needs.

The estimation of the citizens' participation during the time spent administration relies upon two variables. One is the space gave to natives by the state during the time spent the administration which is started from the top. Second, if such space is given, how this procedure is encouraged by the administration. Help of the procedure through which nationals take an interest during the time spent administration includes debilitating the unbending nature of the organization and tranquiling managerial procedures, conveying the needful to pull in nationals to take an interest and, all the more essentially, keeping up natives' assume that their support brings inherent incentive to the administration and adds to the general population great. In spite of the fact that the structure for natives' interest has been given by the Constitution, assistance of natives' support has not happened. There can be two explanations behind this. To begin with, the current structure isn't helpful for pull in nationals to take an interest in administration. Second, there is an open lack of concern towards the breaking down of urban neighborhood administration, which keeps citizens' from taking an interest.

With the dispute of the 'emergency of the governability' in India, which is additionally bothered by expanding examples of debasement, dysfunctionality of open establishments, and expanding financial imbalances furthermore, under-portrayal of the greater part during the time spent administration, the need of great importance is to return to the current examples of natives' cooperation during the time spent administration which can guarantee straightforwardness also, responsibility. For example, in 1977, there was a central agenda for citizens Administration led by many chief ministers from different states in India.

6.2 Understanding and Role of Urban-Citizens' in Governance

The appearance of urban administration in India has developed after some time. If we look back to the Indian politics history the roots of good governance have been emerged through Madras Municipal Corporation in 1867 and Lord Mayo's Resolution in 1850s. Most important role was played by Lord Ripon in 1882 where he had passed the Resolution of self-government in democratic India. On other side, in 1919 the Government of India Act was made and introduced some powers to state government and local bodies. After Independence, the focal point of social and formative strategies had a tendency to be on provincial India and the idea of urban local bodies was not given much consideration. The explanation behind this unlike in urban administration structure was that the Constitution did not offer need to the urban administration and the whole spotlight stayed on the rural part.

The role of citizens in central administration has for some time been a piece of thoughts in general society space in India. The historical worldview of the political framework accommodates linkages to citizens' essentially through appointive governmental issues, popular feeling surveys, consumer loyalty overviews, open hearings, sorted out gathering exercises, and individual contacts. Open meeting and consultation among individual and amongst them and government in the customary worldview has been to a great extent inactive. Mid nineteenth century onwards, establishment was reached out to beforehand reject areas of populace, especially in the western world. In any case, the part of the citizens as a drawn in accomplice in the representing procedure has been insignificant and they have just restricted data about the administration's open undertakings.

The Constitution of India has in-constructed arrangements to ensure the privileges of the nation's citizens' also, guarantee that the financial strengthening of all areas of populace is ensured. The Fundamental Rights are basic for majority rules system while the Directive Principles of State Policy typify the idea of a Welfare State. A solid lawful structure involving the National Human Rights Commission, National Commission for Women, National Consumer Disputes Redressal Commission, Lokayuktas, and governmental policy regarding minorities in society arrangements and so on has been set up. The Eleventh Plan delineated that the center components of good administration are straightforwardness and responsibility in government undertakings, a compelling and productive conveyance of social and monetary open administrations, strengthening of Panchayati Raj Institutions, reasonableness and comprehensiveness of the whole government framework.

However, Indian government in 1988 appointed a new commission “the national commission on Urbanization” which figured it out the capability of urban administration in the financial improvement of the nation and suggested the governance to give quick regard for urban administration. Then, in 1992 government introduced the 74th Amendment Act. With decentralization of intensity and assets, as nearby self-governments, comes the opening up of the procedure of administration. Straightforwardness in basic leadership, divulgence of principles of conveyance and transparency in regular working of the organization, the essential signs of national driven organization, can be made through decentralization. Be that as it may, to guarantee these, it is critical for the administration to furnish its natives with instruments to request data from the legislature at all levels of organization. The Right to Information Act 2005 was a milestone move towards the same.

On other hand, when we talking about urban areas quickly come up in the mind about their governance. There are some essential qualities of urbanization process in India which require an urgent center around urban administration. The principal trademark is the size of urbanization in India, which puts gigantic weight on open administrations, welfare and human and framework improvement, which make challenges in the administration of urban undertakings. The second normal for the urbanization procedure is that it has been does not take after the patterns of financial development. For instance, from autonomy until 1991, Tamil Nadu, Punjab and Karnataka have encountered medium development of urban populace. Conversely, high urban development was enrolled in the other states in particular, Bihar, Uttar Pradesh, Rajasthan, Orissa and Madhya Pradesh.

Hence, as we know for Indian urbanization is that there have been tremendous usage holes in post-autonomous urban strategies. Approaches, laws and change proposition identified with urban approaches like residential communities and non-metropolitan zones nothing have done directly always take time to complete it and next to no has been done to execute them and influence change. A dynamic culture requires that laws are updated what’s more, new ones acquainted with address developing issues of the general public keeping in mind the end goal to address difficulties to residents’ welfare, assurance and improvement as and when they emerge.

Govern of law requires establishments that are very much enabled, legitimately organized and have the correct nature of work force and assets available to them. Further, establishments should be made nearer and effectively open to the residents they are intended to serve. Devolution of government expert and decentralization of organizations deliver productivity in administration and bring subjects specifically inside the crease of honing such expert. Decentralization produces productivity picks up originating from between institutional rivalry, improved balanced governance over the government through voting at the sub-national level, and instructive focal points due to nearness to subject.

Indeed, our governance, under the worldview of the formative state, created as a top—down process, which was started and controlled by the state administration and wherein open doors for nationals to interface with the procedure of administration were uncommon. Under the worldview of state-drove advancement, natives were accepted just as a lawful substance ensured by the constitution, and their open obligations, as rose truly, were constrained to voting. Amid the early post-autonomy period, the Indian state went about as a welfare state with an objective of conveying open products to subjects, particularly poor people what's more, minimized. In any case, these measures did not ensure that the recipients were a piece of the administration process through which benefits were being conveyed to them. Subsequently, the issues that were associated with the procedure of administration amid the early post-freedom period were fundamentally identified with the degree, financing and scope of welfare programs and the related authoritative inadequacies. This entire procedure overlooked citizens' points of view and their claim of interest in administration considerably.

The negative part of Indian arranging that was set up in the initial three decades after freedom is that the state was extremely provoke to bring formative arranging enthusiastically at the unintentional cost of participatory administration. Despite the fact that arranging records have attempted clear endeavors to advocate for a fitting structure of decentralization, there was an absence of readiness with respect to the Indian states to put this structure into the real world. The absence of ability is deducible the suggestions of the First Administrative Reforms Commission (FARC), framed in 1966. The FARC proposed the devolution of budgetary and managerial forces to the most minimal strata of authoritative units which incorporates, in standard, reinforcing of nearby government in both rural and urban territories (GOI 2009).

6.3 Participation in Decentralization Governance and Issues

The period from 1980 to 1990 was a transitional period for urban administration in India. In the 1980s, a few endeavors were advanced by the Indian government in such manner. The Indian government endeavored to establish a Constitutional 65th Amendment Act, 1989 with respect to urban decentralization however, neglected to get it passed. Amid this period, there was a rising worry about the decentralization of urban arranging and administration and incorporation of subjects in the arranging and usage of formative also, welfare projects and plans. Regardless of these activities, the procedure of administration remained top—down in nature and took after the guideline of command. Amid this period, a couple of issues, for example, devolution of assets and network cooperation, which were fundamental for the strengthening of urban bodies, were taken up in scholarly civil arguments and mostly tended to in arranging reports also.

Hence, Neo-liberalism contends for 'reevaluating government' and marks 'great administration' as one in which regulatory changes, open investment and responsibility are in the center of the idea. The idea of 'good administration' battles that administration should be network claimed what's more, the part of government is to enable subjects and networks to practice self-administration by expanding the investment of the general population in the basic leadership process (Singh 2010; 125). In this way, authorization of the 74th Constitutional Amendment is the aftereffect of two parallel wonders. The first is the developing interest of decentralization in urban administration to satisfy the guarantees that have been made in the Constitution. The second is the weight from neoliberal powers which contend for a move back of the state keeping in mind the end goal to encourage greatest open interest in general society process.

As we know, that after the decline of 74th Constitutional Amendment, citizenship has turned into a basic factor that requires prompt scholastic regard for talk about existing examples and prospects of urban administration through which it can assume a more prominent part in making urban administration more participatory and comprehensive. Citizenship, as an idea, other than being a lawful status of an individual set up by the Constitution, is comprehended as a functioning support from a person in the nation. Citizenship gets from an arrangement of center contemplations of rights to which an individual feels entitled, and some ethical commitments that the singular thinks about crucial to them.

In fact, we should not forget that India's a multi cultured nation. In spite of the fact that it is hard to put forth a defense for the nearness of citizenship in a customary Indian culture where society is exceptionally assorted and unfair (Beteille 1999; 2588), engaged and empowered open support in a complex urban setting can convey an incentive to the crumbled society by guaranteeing better personal satisfaction. In India, social identities like class and caste, which by and large have been the reason for social separation, have turned out to be vital in guaranteeing nationals' privileges. The social personality of a individual introduced a urban territory turns out to be either debilitated or value-based, and accordingly, the person loses his/her ability to deal with the political framework. A functioning commitment of a national in open issues can hold a legitimate and esteem driven personality which can guarantee not just straightforward and responsible administration yet additionally a stately life for urban occupants.

Therefore, we seen drawn from the working of local self governance in urban India does not offer extremely energetic bits of knowledge. The Administrative Reform Commission (ARC) watches that urban nearby bodies have not been fruitful in satisfying those destinations which rest in the center of the idea of local self-governance. Some reports refers to cases of such cooperation to incorporate participatory civil planning, enabling subjects to vote specifically through a submission on particular recommendations for changes openly strategies, tasks and laws; required open hearings previously endorsement of ventures or choices, for example, changes in land utilize plans influencing the earth and additionally the nearby network, giving citizens' portrayal on administration boards of trustees for local clinics and schools, social review, enabling the gram sabha to choose issues of usage in government welfare plans and such like.

In fact, after the ARC report had been the focal point of the proposals of both Commissions is to give basic leadership controls in residents' grasp. For this situation, the part of the state needs to move from a 'supplier' state to a 'facilitator' state, and the idea of the urban administration needs to be changed from 'what government does' to 'what natives need'. There are some arrangement of urban administration issues is identified with approach process in urban administration, that is, urban arranging and improvement. As is recognized in the vast majority of the applicable reports identified with urban administration, and as the Constitution reflects, there ought not be an inflexible and uniform model of administration structure for every urban setting the nation over however there ought to be adaptability for each state as far as receiving structure for urban neighborhood administration which is reasonable to the requirements of that specific state. Be that as it may, this adaptability for the states has been abused. States have not satisfied even the base prerequisite for urban local administration.

With the current structure, there is little space for nationals to take part during the time spent administration in urban territories. In this manner, there have been requests to modify the structure of the nearby self-administration in urban territories. ARC, Jawaharlal Nehru National Urban Renewal Mission (JNNURM) rules and command for the states and an ongoing report created by the HPEC on Indian Urban Infrastructure and Services have suggested the correction of the current structure of urban nearby administration and have recommended adjusted structure of nearby administration in urban regions.

Worldwide associations have recognized subject's interest as a potential instrument to make a manageable urban future. In the first place is regarding the privileges of poor people, at the base, while getting ready for an urban future. The second approach activity weights on individuals' improvement in the city with a more extended term and more extensive vision of the utilization of urban space to lessen destitution and advance maintainability. The third activity concentrates more on community oriented endeavors wherein individuals, social developments, foundations and governments meet up to improve the nature and type of urban future. Every one of the three arrangement perspectives has an innate space for natives' interest in the arrangement procedure of urban administration. The substance of this report is significantly based on the requirement for growing such arrangement structure wherein a supportable urban future can be anchored by outfitting the capability of nationals' investment.

6.4 Role of Civil Society

In reality, achievement nearly perpetually requires the concurrent nearness of state on-screen characters keen on building partnerships with civil society, of residents and civil associations that show enthusiasm for taking an interest in open arrangements, and of configuration includes that diminish the uneven dispersion of assets among members. As we have noticed, the civil society can possibly accomplish great government. This stands in guide difference to conventional understanding that it is discretionary intensity, institutional plan, political polarization, bureaucratic limit and financial innovation that decide the strength and responsiveness of governments. Social capital hypothesis has given us an extra informative variable for the same. In any case, what is the rationale of the small scale linkages that tie a network's agreeable ability to accomplishment of good administration?

Civil society commitment makes natives advanced purchasers of legislative issues. Inferable from dynamic investment in network affiliations, residents are given chances to talk about metro undertakings. It builds their attention to political issues, giving them a stage to talk about whether the legislature is doing everything in its ability to enhance the welfare of its kin.

Civil society commitment is advantageous for the administration too. It decreases cost of implementing what's more, actualizing administrative arrangements and controls. To anchor consistence, governments must make mind boggling and expensive components of implementation. Social capital decreases the requirement for such systems by molding the desires nationals have about the conduct of others. In the event that individuals expect their kindred citizens or waste-makers to pay their duties or consent to natural controls, at that point these expenses will probably be borne energetically and the cost of upholding consistence will be low. Social capital, encapsulated in common society associations, improves nationals' requests for aggregate benefits. It empowers the enunciation of requests on government that are to everybody's profit instead of helping a few individuals from society to the detriment of others. Further, it cultivates accommodative practices among the social and financial elites. It is especially useful for districts full of hostile ethnic, religious or class squares.

6.5 Conclusion

We have contended along commonplace lines to build up that participatory administration improves for nationals, better governments and better choices. The consideration of a more extensive range of nationals makes for enhanced flow of data, more prominent oversight over the political process, and more strong open level headed discussion. These apparently prompt more viable and evenhanded approaches. In any case, encounters the world over have shown us this is a long way from handy. So by what method can law based and successful participatory systems be advanced?

Putting citizens at the focal point of regulatory and basic leadership procedures of the government is the sign of a living and flourishing vote based system. It is inseparably connected to an advancement worldview that attempts to make a comprehensive situation where individuals can create without bounds of their abilities, with individuals having productive and impartial access to open administrations. Indian majority rules system has broad lawful and institutional arrangements at different levels of organization to incorporate nationals in the procedures of administration.

The Reports of the Administrative Reforms Commission have managed intricately with the possibility of citizens' administration. These two procedures can be seen to together answer the inquiry: why are a few governments steadier, effective, inventive and very much oversaw than others? This paper has contended that there are two sides to citizens' local administration the request and supply sides. The request side draws on the current social funding to arrange networks in such a way as to end up modern shoppers of governmental issues. On the supply side, the point is to reorient government associations to make them more proficient, powerful and participatory.

It should be recollected that e-government is built up in stages and in view of the financial setting of the state in which it is being initiated. In its developing existence, fundamental data about taxpayer supported organizations is given on the web. With upgrade in its essence, more noteworthy wellsprings of data, e-administrations and e-devices are given. At the point when the nearness graduates to being value-based, two-way intelligent applications can furnish natives with open doors for on the web, budgetary and non-money related exchanges. At long last, with associated presence of ICT devices, the way the legislature works changes essentially, and there is better rationality, mix and coordination of procedures and frameworks inside and over government organizations. The administration changes into an associated element.

In a nation like India where the administration is overburdened, a national enactment like RTI may demonstrate deficient in enhancing government responsibility. In this way, straightforwardness arrangements can be outlined into sectoral enactment to such an extent that they empower aggregate activity. The Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) and Jawaharlal Nehru National Urban Renewal Mission (JNNURM) are the best examples, based on a participatory model.

India has seen different and uneven encounters in regard to societal activities for self-administration. Social preparation and individuals' development in Kerala are illustrations that demonstrates the viability of the request made by society to acquire their rights to represent themselves. Such developments have not been seen in different parts of the nation. These patterns rely on how state—society relations have created after some time. In a vote based political framework, the state needs to encourage channels and sub-routes through which nationals can reach to state. Since the structure of nearby self-administration was truant as of not long ago, nationals have discovered not many purposes of contact with the state. Despite the fact that there have been astounding mediations from common society associations as far as requesting the simple privileges of residents, their scope and effect has either been restricted or overlooked. Indeed, this is one of the confinements of social developments in India, which have mediated at various levels for individuals' interests. There could be a clarification for the restricted stream of requests from nationals for their political rights. India is known for basic separation and prohibition. The larger parts of individuals are segregated by the minority populace based on social relations. Much vitality and exertion appear to be put resources into social changes and equity arranged individuals' developments, potentially taking away from developments on political rights.

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Chapter 7
Environmental Governance: Compliances and Consequences

N. Azhaguraja and Malabika Deo

Abstract The side effect of relentless industrialization has come up in the form of environmental degradation. Environment related issues have been steadily going up especially in the developing countries like India where the awareness about environmental sustainability and environmental governance is at its lowest. Thus, the state of environment is in a very pitiable condition. Though there are numerous environment related enactments which have endorsed the concept of sustainability and environmental protection, the preservation of the environment is in the state of a big question mark. Though the legal implications for non-compliance under the enactments namely, Wild Life (Protection) Act 1972, Water (Prevention and Control of Pollution) Act 1974 (Water Act), Forest (Conservation) Act 1980, Air (Prevention and Control of Pollution) Act 1981 (Air Act), Environment (Protection) Act 1986, Public Liability Insurance Act 1991, Biological Diversity Act 2002, National Green Tribunal Act 2010 (Jawaid et al. 2018) etc., are stringent still the environment related issues are increasing manifold. This paper analyses the legal implication for non-compliance under 8 specific environment related enactments and suggest measures in the form of environmental tax to be imposed on the pollutant industries to deter the environmental degradation.

Keywords Environmental governance · Legal implications · Environmental tax

7.1 Introduction

Environment has a vital effect on the health of a country with respect to its economic and financial resources. At the same time depletion of the environmental resources results in hazardous effect which tells upon the economic condition of the country.

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Hence the environmental ill treatment should not be seen in its face value rather warrants a serious attention as its cumulative effect weakens the country's potential for generation. Hence management of the environment related issues is the prime concern of every country without which the prosperity raises a big question. Developing country like India faces numerous challenges due to environmental degradation, environmental depletions etc., and the various environmental pollution related issues have a direct impact on the socio economic factors of a country (Ghosh 2018). Population and industrialization are the two main factors which cause such environmental degradation and depletions. The citizen of India be it a person or a corporate entity should abide by the fundamental duty of protecting the environment including water, air, forests, and wildlife as per the Constitution of India Article 51-A (g), the rudimentary duty of a citizen is to save the environment from any harm. Industries being the major contributes of environmental degradation in terms of aforestation, CO_2 emission, pollutant and effluent release etc. The concept of preservation and giving something back to the society is the social responsibility of everyone. Environmental governance "is the process by which one applies the best environmental practices, complies to the regulations concerned with management of environment related issues so as to leave something for the future generations".

As per the recent survey of Environmental Performance Index 2018, India is ranked as the 177th country out of 180 countries, which indicates that the environmental concern in India is very poor and Indian environment is at high risk (YaleNews 2018). Hence the Government has to take necessary steps to address the environment related issues by creating sufficient awareness among the people and implementing stringent provisions by way of bringing necessary amendments in the existing environmental enactments. It can prove to be a forward step to bring a quality environment similar to the other developed countries. From this study one can understand the seriousness of the implications for non-compliance under environmental enactments and the environmental status of India in contrast to other 180 countries. The legal implications especially for the corporate entities are not only punitive but also contribute in enhancing the goodwill and reputations of the business. Hence the corporate entities are advised to go beyond the compliance for the sustainable development not only for the corporate but also to the entire world and for the future generations.

7.2 Cost of Non-compliance Under Environmental Related Enactment

7.2.1 Wild Life (Protection) Act 1972

This Act was enacted with the view to protect the plants, wild animal and birds. The Act elaborates on the provisions through VII chapters. Chapter 2 deals with the appointment/establishment of authorities/Board, Chap. 3 & IIIA elaborates the provisions related to hunting of wild animals and protection of specified plant, Chap. 4

& IVA explains the provisions relating sanctuaries, national park, closed areas, central Zoo authority and its recognition, Chap. 5 & VA provides for the trade or commerce in wild animals including animal articles, trophies and its prohibition, Chap. 6 deals with prevention and detection of offences, miscellaneous provisions are dealt under the Chap. 7. The following are the legal implication for the contravention of the provisions of the Act.

Section	Particulars	Penalty	
		Imprisonment	Fine
51	Any person who contravenes any provisions of this Act other than Chapter VA and Section 38J or any rule or order made thereunder (MoEFC 2006)[a]	3 years	25,000

[a]Ministry of Environment, Forest and Climate Change, Government of India

7.2.2 *Water Act 1974*

The Water Act was legislated in the year 1974 for the purpose of protecting and controlling pollution relating to water. For the purpose of achieving the above-mentioned objective, the Act empowered the Appropriate Government to constitute appropriate Board for the implementation of the Act in an effective way. The Board has the power to obtain information, to enter into any place for the inspection, to take water samples for analysis and impose certain prohibition for the use of stream or well for the effluent disposable etc., In the year 1977, another Act called Water Cess Act endorsed the appropriate Board to impose cess on certain industries and local authorities for their water consumption. The following are the provisions relating to the penalty under the Water Act.

Section	Particulars	Corresponding section	Penalty	
			Imprisonment	Fine
41	Failure to comply with directions	20(2) or (3)	3 months	10,000
		32(1)(c) or 33 or 33A	1 year 6 months–6 years (continued 2–7 years)	5,000 for every Continuing offence
42	Penalty for certain acts	25 or 26	3 months	10,000
43	Penalty for contravention	24	1 year 6 months–6 years	
44	Penalty for contravention	25, 26	2–6 years	
45	Enhanced penalty after previous conviction	24, 25, 26	1 year 6 months–7 years	

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Section	Particulars	Corresponding section	Penalty	
			Imprisonment	Fine
45A	contravention of the provisions		3 months	10,000
46	Publication of names in the news paper	At the cost of the offender		
47	Offences by companies	Liable to be punished accordingly		
48	Offences by government departments	Liable to be punished accordingly		

7.2.3 Forest (Conservation) Act 1980

This Act was established with primary objective of conservation of forest, restriction to use forest land for non-forest purpose. The Act enables the Central Govt. to establish committee for the purpose of implementation of the Act in an effective manner and to issue direction and make rules. The penalty provision under the Act is as follows.

Section	Particulars	Corresponding section	Penalty
			Imprisonment
3A	Contravene of the provisions of the Act	2	15 days

7.2.4 Air Act 1981

This Act was established in 1981, with the objective of preventing and controlling of pollution related to air. For the purpose of administration of the Act the Board which is set up under Section 3 of Water Act 1974, was vested with the necessary powers and functions to prevent and control air pollution and in States where no such Board exists then the State Government is empowered to constitute its own Board and constitute a state air laboratory (Ananth 2007). The Board has the following powers namely, to restrict certain industrial plant, to obtain information, to enter into any place for the inspection, to take samples for analysis. In the year 2000, the Central Government framed rules known as the Noise Pollution (Regulation and Control) Rules with the view to control noise pollutions produced from various sources. The following are the provisions relating to the penalty under the Air Act:

Section	Particulars	Corresponding section	Penalty	
			Imprisonment	Fine
37	Non-Compliance or adhere the directions of Section 31A	21, 22, 31A	1 year 6 months–6 years (continued 2–7 years)	Fine (continues 5000 P.D)
38	Penalties for certain acts	21, 23(1)	3 months	10,000
39	Penalty for contravention		3 months	10,000 (continued 5000 P.D)
40	Offences by companies	Liable as per the provisions of the Act		
41	Offences by Govt. Departments	Liable as per the provisions of the Act		

7.2.5 The Environmental Protection Act 1986

The Central Government in the year 1986 brought an Act called Environment Protection Act by imposing accountability to the authorized person responsible for industrial operation, compliance and reporting of the environmental related matters. For the purpose of effective implementation of the Act, the Central Government is empowered to appoint officers, to issue direction, to make rules, to set emission standards for the industry, have power to enter, inspect, to take sample for analysis and to establish required number of environmental laboratories. From the year 1992, the Environment Protection Rules, 1986 mandated that the concept of environmental audit and reporting of the same by such person or industry which are covered under the Act (ICSI 2016).

Section	Particulars	Corresponding section	Penalty	
			Imprisonment	Fine
15	Contravention of the provision, rules, orders and directions		5 years (continued 7 years)	1,00,000 (continued 5,000 P.D)
16	Offences by companies	Liable as per the provisions of the Act		
17	Offences by Government Departments	Liable as per the provisions of the Act		

7.2.6 Public Liability Insurance Act 1991

For the purpose of protecting the person and provide some relief to those who get affected by the person or industries handling in hazardous substances etc., an Act called Public Liability Insurance Act established in 1991 to impose accountability by way of subscribing one or more policies to protect and provide relief to those who got affected by such hazardous substances. The Central Government is empowered to issue direction, to call for any information, entry and inspection, to establish environmental relief fund, such fund is handled by the collector with direction of the Central Government.

Section	Particulars	Corresponding section	Penalty	
			Imprisonment	Fine
14	contravene of the provisions of the Act	4(1), (2), (2A), (2C) & 12	1 year and 6 months 6 years Continued 2–7 years	1,00,000
15	Failure to comply with the direction	9, 10, 11(1) (3)	3 months	10,000
16	Contravention by the company	Liable to be punished accordingly		
17	Offences by Government Departments	Liable to be punished accordingly		

7.2.7 Biological Diversity Act 2002

Under this Act, the Appropriate Government has the power to establish Biodiversity Board, biodiversity management committee and Local Biodiversity funds etc., with the view to implement the provisions along with the detailed procedure for the NRI companies' clearance and to advice Government on the specific areas of the biodiversity. The legal implications under the provisions of the Act are as follows:

Section	Particulars	Corresponding section	Penalty	
			Imprisonment	Fine
55	Contraventions the provisions of the Act	3, 4, 6	5 years	10,00,000
		7, 24(2)	3 years	5,00,000
56	Failure to comply the direction given or order made by the state, Central Govt. the NBA or the SBA Board		1,00,000 (continued 2,00,000)	

(continued)

(continued)

Section	Particulars	Corresponding section	Penalty	
			Imprisonment	Fine
57	Offences by Company	Liable to be punished accordingly		

7.2.8 Environment Impact Assessment Notification 2006

These draft rules were brought in the year 2006 with a view to impose certain conditions and prohibition on the implementation of the new or modernized project which may cause potential risk to the environment. The notification lays down the procedure for prior environmental clearances, its validity and monitoring etc., the penalty provisions under the notification are as follows:

Section	Particulars	Corresponding section	Penalty	
			Imprisonment	Fine
8 (vi)	Purposefully providing false or misleading information.	Rejection and/or cancellation of clearance		

7.2.9 National Green Tribunal Act 2010

The Act was enacted for the purpose of establishing a specialized Tribunal to settle the environmental disputes in an effective and efficient way, compensate to such person or persons for the damages or loss listed in the first schedule of the Act.

Section	Particulars	Penalty	
		Imprisonment	Fine
26	Non-compliance of orders of Tribunal	3 years	10 crores (continued 25,000)
	Non-compliance of the orders of the Tribunal by the Company		25 crores (continued 1,00,000)
27	Offences by the company	Liable to be punished accordingly	
28	Offences by Government Departments	Liable to be punished accordingly	

7.2.10 Plastic Waste Management Rules 2016

These rules are applicable to local body, gram panchayat, manufacturer, importers and producer who are directly or indirectly involve in the process of waste generation and their responsibility in handling the waste substances and waste management. State level monitoring committee and annual reports are the key provisions under the rules.

Particulars	Corresponding section	Penalty	
		Imprisonment	Fine
Responsibility of authorized person	As per the bye-laws of the local bodies		

7.2.11 E-Waste (Management) Rules 2016

These rules are applicable to every person who is directly or indirectly involved in the purchase, produce/manufacture, store, processing or selling of electronic waste materials which are listed in I scheduled of the rules. These rules prescribe certain responsibilities to the above mentioned persons and procedure for grant of authorization so as to reduce the use of the hazardous substances of e-waste.

Section	Particulars	Corresponding section	Penalty	
			Imprisonment	Fine
21	Liability of person authorized under the Act	As per the rules of the SPCB[a] in consultation with CPCB[b]		

[a]State Pollution Control Board
[b]Central Pollution Control Board

7.2.12 Bio-Medical Waste Management Rules 2016

These rules prescribe certain duties to those persons who handle all types of bio medical waste and the effective disposal and management of such bio medical waste are also dealt under the rules including procedure for authorization and annual reports, maintenance of records are the key provisions.

Section	Particulars	Corresponding section	Penalty	
			Imprisonment	Fine
18	Liability of the occupier, operator of a facility	As per Section 5 and 15 of the Act		

7.2.13 Construction and Demolition Waste Management Rules 2016

The rule is applicable to every person who are directly or indirectly involve in the process of generation of waste from construction and ancillary activities, the rule also prescribe certain primary duty in handling, management and disposal of such waste in an effective way so that such substances are not harmful to the environment.

Section	Particulars	Corresponding section	Penalty	
			Imprisonment	Fine
	Non-compliance of the provisions of the Act	As per the penal provision of the EP Act, 1986		

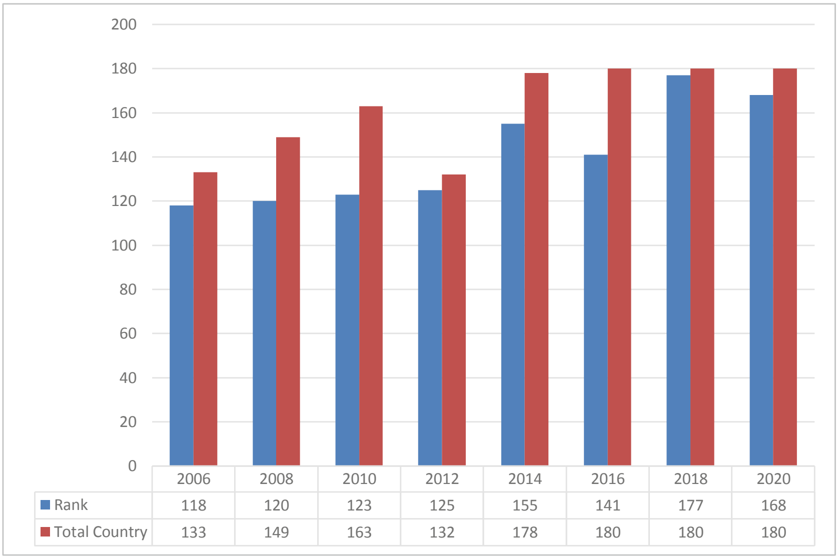
7.2.14 Hazardous and Other Waste (Management and Transboundary Movement) Rules 2016

The provisions of the rules are applicable to such hazardous waste and substance listed in the schedules to the rules. The rules also prescribe responsibilities to those who are processing, managing, handling and disposing of such waste in an effective and efficient manner so as to protect the environment from such hazardous substances or waste.

Section	Particulars	Corresponding section	Penalty	
			Imprisonment	Fine
23	Liability of person authorized under the Act	As per the rules of the SPCB with the prior approval of the CPCB		

In the back drop of several enactments to protect environment of the country may it be air, water, India's position on Performance Index in terms of international parameter is very poor. EPI was developed for the purpose of evaluating the environmental issues and challenges that are prevailing in a country as compared with the rest of the world (Yale 2018). The 2020 Environmental Performance Index (EPI) scores consist of 32 variables such as environmental health, ecosystem vitality including CO_2 emission and waste management etc., for 180 countries.

India's Environmental performance Index



Source (Wendling 2020)

From the above table, one can conclude that the India environmental performance index as compared to the total number of countries taken together is considered to be very bad. The years 2010 and 2016 are having better index as compared with the other years index i.e., 2010–75.46% and 2016–78.33% but in the case of 2012, 2018 and 2020 are having poorest performance index i.e., 2012–94.70%, 2018–98.33% and 2020–93.33. Though the current index of India's environmental performance index is better than the previous index i.e., 168th rank (2020) improved index as compared to 177th rank (2018). This index is a sign of danger that are caused not only to the environment but also to the human kinds. If the government of India doesn't take any steps to govern this, India also will be considered not fit for living country.

7.2.15 Environmental Taxes

"OECD defines an environmental tax as a tax whose tax base is a physical unit (or a proxy of it) that has a proven specific negative impact on the environment. Four subsets of environmental taxes are distinguished: energy taxes, transport taxes, pollution taxes and resources taxes" (OECD 2005).

Though there are numerous enactments in India for the specific as well as general protection of the environment, but still the environmental degradation is becoming worse. Though the technological advancement including liberalization, privatization and globalisations are important for every developing country to space with the other countries and develop its own economy. It should not be at the cost of one's own environment because the long term implications of it may prove detrimental for even the existence of the country. Moreover, the penalties imposed under various enactments are so meager as compared to the loss made to the environment. That is the reason why India has become fourth country from the last 18 countries. Since, there are no taxes imposed on the companies polluting the environment (Kini 2017). In order to preserve the environment, environmental taxes can be imposed on the companies and at the same time tax exemption can be provided to such companies which contribute for the purpose of preservation of environment. By this way India can preserve, protect and improve the environment.

7.3 Conclusion

India is considered to be the fastest growing population in the world but with respect to protection and preservation of environment and environmental issues India is far behind as compared to the other countries. Developing countries economic policy should also pay some concerns to its environmental developments and conservations why because the damage done to the environment is irreparable. Though India has numerous enactments and environmental policies which emphasize on the compliance and penal provisions for the non-compliance etc., it is in the hands of every professions especially compliance officer like Company Secretaries to imbibe these provisions and practice in their respective companies in such a way so as to bring a Model Governance Mechanism which may be suggested to the other companies as well as to the other professions. As per the Ministry of Environmental, Forest and Climate Change, industries are the major contributors for the environmental pollutions, hence the Central Pollution Control Board has notified 17 industries which are considered to be the most pollutant in terms of producing hazardous substance and regulating the same by way of establishing specified standards, monitoring and control mechanism. Such suspended particulates, gases and other effluents are not only damages the environment but also affect the health of the human kinds. Hence a special tax called Environmental Taxes can be imposed on the company every year based on the Companies Environment Impact Assessment, reporting and compliance by way of Environmental Accounting, Social Responsibility accounting and Environmental Governance reporting etc. This approach will surely make the citizens including corporate citizens to be morally conscious not to damage the environment and also revenues raised in the name of environmental taxes can be utilized to protect and maintain the damages caused to the environment.

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Chapter 8
Shari'ah Governance: A Solution to Corporate Governance Problem

Yashfeen Ali and Areeba Khan

Abstract When an outside investor exercises control differently than the manager of the firm that is when the corporate governance problem arises. The problem of conflicts between the stakeholders magnifies with dispersed ownership, it also creates collective action problem among investors. Some studies have identified five alternative mechanisms which can mitigate this problem:

(1) Control in hands of one investor or few of them or giving partial ownership.
(2) Concentration of ownership by hostile takeovers and proxy voting contests.
(3) Control by the board of directors.
(4) Executive compensation contracts are given to investors to align managerial interests.
(5) If the decisions have harmed or blocked the corporate decision that goes against the investors a fiduciary duty is assigned to the CEO.

Shari'ah governance encourages honesty, integrity, transparency, accountability and responsibility among stakeholders in an organisation. Shari'ah board plays a very significant role in controlling and monitoring business transactions for the purpose of Shari'ah compliance. It follows ex-ante and ex-post criteria. AAOIFI and IFSB has set up guidelines for a sound corporate governance. In many ways Shari'ah governance can help the governance problems being faced by the corporations but there are some pros and cons as well regarding their implementation. Though the core Islamic laws cannot be followed in all the conventional countries but the principles or rules mentioned for a sound Shari'ah governance can be used so as to protect the economy from all kinds of frauds or losses. This paper will portray the benefits of *Shari'ah governance*. It will also be dealing with the corporate governance problems faced by the organisations and how these problems can be overcome by implementing *Shari'ah* Corporate Governance.

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Keywords Shariah governance · Corporate governance · Corporate governance problem · Stakeholders

Corporate governance is a mechanism used to protect the rights of the stakeholders and ensures that the managers and insiders are acting according to the guidelines set for them.[1] Corporate Governance implies a set of relationships between a company's management, its board, its shareholders and other stakeholders.[2] Corporate governance is inevitable for developing investor's confidence and also for proper working of the economy. The main idea of Corporate Governance is to recommend set of processes, custom, policies, laws and regulations affecting the working of a company.

Failure on corporate governance was the reason behind financial crisis that was suffered. The corporate governance principles to be strong enough for the corporations is the responsibility of the regulators. Many financial institutes had to face losses post financial crisis and the reason behind that was poor corporate governance. There is a relationship between corporate governance and financial performance. So as to monitor the conduct the companies use corporate governance tools.

Corporate governance is used to describe the balance maintained by corporations among the participants in the corporate structure who have interest in the corporations. It directly has an effect on the profits, reputation and policies of the company which can expose them to lawsuits, fines, goodwill damage and loss of capital. Corporate governance policies have to go through following downfalls: (Organization for Economic Co-operation and Development, 2004).

(1) **Conflicts of interest**

It happens when the controlling member of the corporation has other financial interests that directly affect the objectives of the corporation. Avoiding this type of conflict is vital. If this type of conflict occurs that it can deteriorate the trust of the shareholders and the public thus, making the corporations vulnerable to litigations.

(2) **Oversight issues**

The board of directors are required to have a substantial oversight of the company's procedures and practices for the governance to become effective. It means that the executive staff should report to the board and the board's awareness of the daily operations of the company by which they achieve their objectives.

[1] Munisi and Randøy (2013).

[2] Al-Haddad et al. (2011).

(3) **Accountability issues**

Effective governance can be achieved if the employees should report and be accountable to another system of checks and balances. The actions of the corporations are accountable to the shareholders and the public. If accountability is not there then one division of a corporation might endanger the success of the entire company or just cause the stakeholders to go into losses.

(4) **Transparency**

Corporations must be transparent and should report all the profits and losses figures to those who invest in their company. A lack of transparency can also expose a company to fines from regulatory agencies.

(5) **Ethics violations**

Board members should make decisions based on the interests of the stockholders. The corporations have ethical duties not only of giving interest to the shareholders but also to duly protect the social welfare of others including greater community in which they operate. For example, minimizing pollution, adhering to labour standards.

(6) **Getting the Board right**

The law requires the board to follow the rules properly for good governance, but it also states that it should have a healthy mix of executive and non-executive directors and there should at least be one-woman director for diversity.[3] Most of the companies in India try to comply with the rules on paper only. Innovative solutions should be implemented so as to make the corporates use governance practices in proper manner and publish results using performance evaluation mechanism.

Islamic version of corporate governance is known as *Shari'ah* governance. If a corporation wants to call itself an Islamic corporation then it has to follow all the guidelines mentioned for *Shari'ah* governance. For a governance to be called as good and effective, it has the following components:

(1) Transparency: Shari'ah governance should be as transparent as possible as it ensures predictability and confidence in the processes. Transparency in Islamic finance is played more importance than in conventional as from Holy Book to norms of functioning in a market focus on transparency.[4]
(2) Disclosure: Full disclosure is an effective instrument to promote social accountability and corporate transparency this aspect is as important as in Islamic concept as it is in conventional one.[5]
(3) Accountability: If one of the above stated components fails, then the rest of them also fail to achieve its targets. *Shari'ah* governance have much refined objectives as compared to its conventional counterpart. Main tenets of conventional

[3]Companies Act, 2013.

[4]Lewis (2005).

[5]Baydoun and Willett (2000).

corporate governance are shareholders and the stakeholders but in the case of Islamic governance, they are God, and then shareholders and stakeholder.[6]

8.1 Methodology

The main objective of the research is to conceptually evaluate, if the *Shari'ah* laws are implemented how the corporate governance problems can be solved. This paper is among the few of the papers to shed light theoretically on the implementation of *Shariah* governance in the systems where Islamic laws are not followed. The objective of the paper is to establish the relation and findings within the conceptual, theoretical and foundational dynamics of *Shari'ah* governance. As it is a conceptual paper, an exploratory research was conducted so as to identify and to gather literature and then analysis was performed.

8.2 Literature Review

Corporate Governance has become the limelight of the corporate world in the recent years and the concept is not different from Islamic principles. The concept of governance came into existence when there was a need to protect the rights of the stakeholders including minority shareholders. Good governance can promote flow of investment, lowers the cost of capital and supports the string capital market.[7] There are few studies on the comparison of Islamic governance with conventional form of governance. The definition of corporate governance states that, "it is the way the board oversee the running of a company by its managers and how these are accountable to shareholders, stakeholders and the company" but this definition does not mention about accountability to God which is a crucial factor in *Shari'ah* governance. Who makes the investment decision in an organisation, what type of investment is made and how the returns are distributed, are the major aspects that construct the corporate governance structure. These are also the principles of *Shari'ah* governance.[8]

Shari'ah governance helps the corporations at all levels in order to bring transparency and effectively complete the different tasks and objectives of the organisation. Several countries have Financial Institutes specifically for dealing in Islamic finance (for example in Malaysia, AAOIFI and IFSB). The problem with these regulations are that they cannot be implemented in the whole world and cannot be uniformly implemented in all the Islamic corporations.

This concept emerged in the 19th century after the inception of Islamic banking and finance. The emergence of the number of *Shari'ah* compliant companies led to the formulation of corporate governance rules. There is no specific unified Arabic

[6]Muneeza and Hassan (2014).

[7]Fotiuh (2010).

[8]Lazonick and O'Sullivan (2000).

phrase which was formulated for Islamic Corporate Governance. *Hawkama* can also be interchangeably be used, this term was coined by Egyptian Linguistic Department[9] Everything in this type of governance begins from the God and ends to the God. Like in the case of interest (*riba*), Quran clearly mentions that it's not only harmful for the individual but also for the society. Breeding money is not allowed in Islam. The basic belief of Islam is on oneness of God (*tawheed*), every individual is responsible for their own deeds. But they are also responsible for the society this brings in the concept of "Accountability".

Shari'ah Governance is divided into different tiers:

1. In the case of corporations, the activities conducted by them should be dependent on the affairs mentioned by the God in the Holy Book.
2. This is developed to achieve the objective of the former tier. In this, several bodies are created to make the affairs of the corporations accountable to God and then to humans who invested in those corporates.
3. Benefiting the society by giving alms, which is known as *Zakat*.

According to Hassan (2009), *Shari'ah* and conventional governance are different. All the models of conventional governance should not be taken as one. Each of them has its own attributes, thus, signifying corporate models. The models differ from country to country and region to region. In some of the countries market plays a vital role like in the case of Germany and Netherlands, shareholders do not have substantial power in managing companies and thus they follow two tier board system. In Latin countries the governance structure is a combination of Anglo Saxon and Germanic structure as they have a choice to choose between the two. In Japan family values are taken as part of governance system.[10] The CEO is vested with the decision-making power of the corporations. The main objective of the corporations is to maximize profit for the sake of shareholders.[11] In the case of *Shari'ah* governance the decisions of the corporates would be based on the *Shura* or consultation. This structure is based on the two-tier system in which an independent board would be setup to safeguard the Islamic element and Board of Directors will manage and direct the corporations. According to the study conducted by Hassan (2009), it has made the *Shari'ah* corporate governance model a two-tier structure involving *Tawheed* & *Shura*. These are the most important constituents of the board and stakeholders.

IFSB (Islamic Financial Services Board) has conducted a study on 69 IFIs established in eleven countries namely, Bahrain, Brunei, Indonesia, Iran, Jordan, Malaysia, Pakistan, Qatar,

Sudan, the UAE and Bangladesh. It was found out that the *Shari'ah* governance has many benefits but it also has some flaws which are according to the *Shari'ah* scholar's perceptions.

For dealing with the corporate governance problems the *Shari'ah* governance can help in the following ways:

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[9] Supra Note 4.

[10] Malekian and Daryaei (2010).

[11] Supra Note 4.

1. Independent committee

Every company should have an independent committee, these will supervise the activities and management of the corporations. This is necessary as in this way the corporations will be in a better position to advice on the doubtful activities happening in the company. This has been clearly mentioned in the AAOIFI standard where the *Shari'ah* supervisory Board has been defined in the following manner, "an independent body of specialized jurists in *fiqh muamalat* (Islamic commercial jurisprudence), and may include a member who is an expert in the field of Islamic financial institutions and with knowledge of *fiqh muamalat*, which is entrusted with the duty of directing, reviewing and supervising the activities of the Islamic financial institution in order to ensure that they are in compliance with Islamic Shari'ah rules and principles through the fatwas, and rulings which are binding on the Islamic financial institution."[12] By this it means that the scholars should have expertise about the rules and regulations and should have practical experience in the relevant field. The rationale behind creating of independent committee is that the committee will perform a farsighted duty, deal and make transactions according to the interest of the investors. The committee will introduce financial transactions consistent with the rules and regulations not just on paper. Lastly social responsibility should be taken care of in a proper manner. These rules are mentioned in the *Shari'ah* governance codes but explained with the help of Islamic laws. The committee shall conduct meetings once a month and it is mandatory for all the members to be present.

2. Board of directors

The committee decision should be binding on the Board of Directors. If this is not the case, then the Committee is wasting time and giving false impression not only to its shareholders but also to its stakeholders. As some decisions might not be accepted by the CEO and BOD and the end result would be that there is no use of Committee thus making it hard for the corporate governance problems to be solved. These guidelines are also mentioned in the AAOIFI guidelines issues for *Shari'ah* governance but in according to Bank of Negara this element is missing.

3. Consultation

In the *Shari'ah* governance codes this is known as consultation if it is implemented then the decisions which are made should be in consensus with the corporate laws. In the Holy *Qur'an* it is been said, "And consult them on affairs (of moment). Then, when you have taken a decision, put your trust in Allah (3:159). Those who respond to their Lord, and establish regular prayer; who (conduct) their affairs by mutual consultation; who spend out of what we bestow on them for sustenance (42:38). Consultation will also help in conflicts of interest. All the people involved with that corporate will have a say thus making the situation a "win-win situation".[13]

[12] Supra Note 6.

4. Sub-committees

These will facilitate the main committee to keep track of everything happening in the corporation without depending on the reports of each department. This will improve the quality of decision. In *Shari'ah* governance codes its mentioned that the sub committees should be established so that the problems faced by *Shari'ah* scholars working like non-executive directors gets solved.

5. Auditing

It should be done once a year the details of the report should be clearly mentioned in the annual report of the corporation. This will bring transparency in the company. The auditors play a vital role as they bring financial integrity. They are known as the "guardians of the company's financial integrity"[14] They should be independent of the company and expected to report without compromise. In *Shari'ah* governance, there are two aspects namely, audit and *Shari'ah* audit. Transparency in Islam can be explained with the concepts of honesty and trustworthiness.

6. Shareholders role

The stakeholders owe duty of care and accountability but the shareholders should also be vested with some powers. If some shareholders want to guard the value of equity and want to acquire high quality rate of return, if they want to assure the value of their deposits, regulating or supervising the activities of the corporations keeping it away from problems and crisis, setting up minimum standards for intelligibility and expose, interested in having resourceful financial market. All these practices should be scrutinized and catered within the parameters. This is mentioned in the *Shari'ah* governance codes where it's been said that the parameters should in accordance with the Islamic corporations.

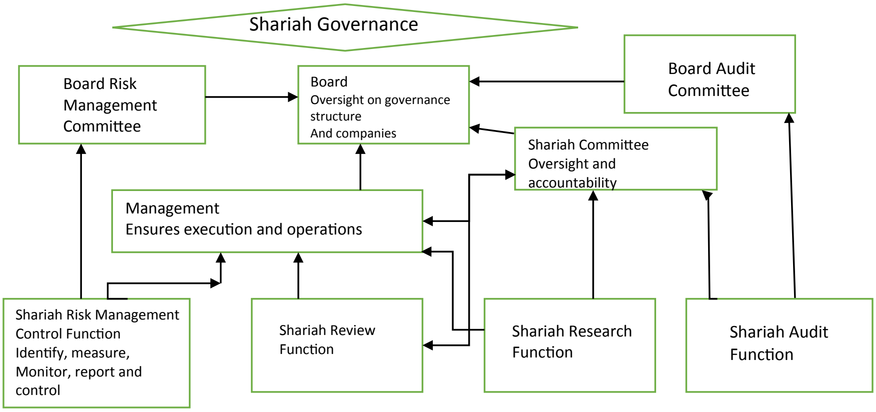
7. In case of pure negligence, the committee can be sued.

All these guidelines are clearly mentioned in the AAOIFI guidelines and if these are followed in the way mentioned above then good governance can be achieved. It is a difficult task to implement *Shari'ah* governance in the countries which are not Islamic. In that case the guidelines mentioned should followed respectively as these do not mention anything about the Islamic laws. The guidelines are just been derived from the laws but they do not follow Islam in it (AAOIFI Standards, 2002).

The model which is followed in conventional corporate governance should be replaced with the *Shari'ah governance model* which is as follows:

[13] Mawdadi (1974).

[14] Krishnan (2010).



Source BNM's SGF (Bank Negara Malaysia, 2012)

8.3 Conclusion

As such there is no specific *Shari'ah* governance model which is followed uniformly in all the Islamic corporates. The western world is still not aware about the concepts of *Shari'ah* governance which can help them attain social justice and welfare. As it even differentiates from just a simple profit seeking mechanism of finance. But since one of the main reasons of financial crisis and the current financial issues in the country like India are the lack of governance in the corporations. *Shari'ah* governance's rules can really help the economy in dealing with the crisis period or any kind of frauds happening in the corporates. It is difficult to implement proper *Shari'ah* guidelines in a country which does not follow Islamic laws but the main gist of the guidelines can be adopted and implemented in the corporate governance codes.

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Part III
Social Responsibility

Chapter 9
Examining Some Options for Deducting CSR Expenses

H. J. Kloppers

Abstract One of the most effective instruments at a government's disposal in framing a corporate social responsibility (CSR) policy is the use of fiscal incentives such as taxes. Through the use of taxes, governments are in a position either to punish social irresponsibility, or to reward and incentivise socially responsible practices. Taxes are increasingly used as an instrument to deter practices that could be labelled as undesirable. Conversely, preferential tax treatment could also encourage businesses to engage in CSR through, for example, the deductibility of CSR expenditure. However, the South African Income Tax Act 58 of 1962 makes no reference to or special provision for CSR expenditure as deductible expenditure in terms of the Act. In order for expenditure to qualify as a deduction, section 23(g) of the Act requires an amount to be laid out or expended *for the purposes of trade.* Accordingly, in order for taxpayers to claim CSR expenditure as deductible expenditure, they have to demonstrate that the expenditure was trade related and actually incurred in the production of income. This poses certain challenges for CSR expenditure. The issue of deductible CSR expenditure came before the court for adjudication in *Warner Lambert SA (Pty) Ltd v Commissioner, South African Revenue Service* 2003 (5) SA 344 (SCA). This article will examine the mentioned judgement to assess whether this case is applicable for a possible future deductibility of CSR expenditure. The central issue at hand in the *Warner* case was business expenses incurred to retain a 'license to operate'. This issue was recently dealt with in a SARS Binding Class Ruling (BCR). The ruling will be assessed to establish whether it provides insight into future SARS approaches to certain CSR expenditures. Furthermore, the article will elaborate on possible tax arrangements that provide businesses with a tax benefit when undertaking CSR expenditure. The focus will be on the possible use of Public Benefit Organisations (PBOs) to further CSR initiatives, and the tax treatment of donations made to these PBOs. The article will also discuss the current provisions in the *Income Tax Act* for charitable donations and its tax treatment.

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9.1 Introduction

9.1.1 Problem Statement

Corporate social responsibility (hereafter abbreviated as CSR) is not a new notion. The roots of this approach can be traced back to the early 20th century (Carroll 2008: 20; Kloppers 2015: 2–3). The notion of CSR has been researched from various angles within the social sciences, from a communication to a corporate governance perspective; from elaborate business models in the field of commerce to the theoretical substratum of its legal dimension (Bronne). Suffice to say that CSR is a well-researched and still highly relevant field of study given its numerous dimensions. Over time, CSR has been established as a crucial component of corporate culture. Hence, it has been identified as one of the pillars of good corporate governance, and in most jurisdictions, businesses are encouraged to act on their social responsibilities in order to 'give back' to society. Businesses are encouraged to become involved in CSR initiatives and make a meaningful contribution to the upliftment and empowerment of the society in which they operate. The pressure to act on a social responsibility is predominantly societal, and consequently voluntary for the most part (Kloppers 2015: 2).

There is, however, a notable exception—references to socio-economic development in terms of the Broad-based Black Economic Empowerment (BBBEE; commonly referred to as BEE) framework and its accompanying weighting on the various BEE scorecards. In this regard, CSR in the South African national context is largely voluntary and businesses are left to their own devices to decide whether and to what extent they want to engage on this front. This is met with limited consequences for 'non-compliance' and also scant explicit encouragement from Government for businesses to act in a socially responsible manner. This (perceived) lack of encouragement is evidenced in the area of taxation where the current Income Tax Act 52 of 1968 (South Africa 1968, the ITA) offers limited tax benefits to those businesses wishing to receive a tax benefit for their 'CSR expenditure'. This is despite the fact that the use of fiscal incentives such as preferential tax treatment is one of the most effective instruments at a government's disposal to frame a CSR policy. Through the use of taxes, governments are in a position either to incentivise socially responsible practices or to punish social irresponsibility. The use of taxes represents an important instrument to deter practices that could be labelled as undesirable. Similarly however, preferential tax treatment could also encourage businesses to engage in CSR by, for example, utilising the deductibility of CSR expenditure or by providing avenues through which CSR expenditure can receive beneficial tax treatment.

The ITA makes no reference to or grants special provision for CSR expenditure as deductible expenses in terms of the Act. The issue of deductible expenditure is addressed in section 11 of the Act (the general deduction formula). Section 11 deals with the general deductions allowed in the determination of a taxpayer's taxable income, while section 11(a) provides an indication of which expenditure would be deductible when determining tax liability. In terms of section 11(a) only expenditure and losses *actually incurred in the production of the income* will be allowed as a deduction against gross income, provided that such expenditure and losses are not of a capital nature. To qualify as a deduction, section 23(g) of the Act stipulates that the expenditure should be laid out or expended *for the purposes of trade*. Accordingly, for taxpayers to claim CSR expenditure as deductible expenditure, they must (according to the current framework) demonstrate that the expenditure was trade-related and actually incurred in the production of income. This poses significant challenges for CSR expenditure which will be examined in this article.

The general deduction formula has limitations with regard to the deductibility of CSR expenditure that are not incurred in the production of income, nor expended for the purposes of trade. Given this fact, this contribution will elaborate on possible tax arrangements available to businesses aiming to receive a tax benefit for CSR expenditures. The focus will firstly, be on the possibility to deduct CSR expenditure in terms of the general deduction formula and secondly, the possible use of Public Benefit Organisations (PBOs) to further CSR initiatives. The contribution will also discuss the tax treatment of donations made to these PBOs and the current provisions in the ITA-related charitable donations and its tax treatment. However, before examining the tax aspects it is necessary to establish what is understood under the term 'CSR expenditure', which could be best described by way of a case study.

9.1.2 Case Study

To help illustrate the deductibility of CSR expenditure, the following case study will be used. An established local company that renders short-term insurance has, as part of its CSR or social-awareness campaign, decided to provide 'points-persons' in some of the major South African cities (including Johannesburg and Cape Town) to help regulate the flow of vehicles in certain traffic hotspots. To facilitate this process, the company purchased a number of motorcycles and neon vests branded with the company's logo.

The points-persons use these motorcycles to reach the hotspots rapidly, and the brightly coloured vests make them easily visible to the road users. These points-persons are not in full employment of the company. The majority of these workers do not have alternative employment during the day and are from underprivileged backgrounds. As a result, the company provides them with various skills training to help them obtain full-time employment. A selected few are also provided with scholarships to further their level of education. These mentioned actions have corresponding expenses, which the company could consider deducting from its income tax liability.

9.2 CSR Expenditure

It is well-documented that no single globally accepted definition for CSR exists (Carroll 1979; Horrigan 2010; Okoye 2009). Therefore, the legitimate question may be posed whether a universal definition would serve a real purpose. Defining CSR is fraught with difficulties; this contribution will avoid engaging in the debate to define CSR from a singular perspective. However, since this article focuses primarily on expenses that can be labelled as 'CSR expenditure', it is unavoidable that such expenditure should be distinguished from other forms of payment. The ITA makes no reference to expenditure incurred on CSR programmes or, for that matter, define the term expenditure. The Act simply refers to *expenditure in the production of income* which are *trade related* (ss 11(a) and 23(g)). Therefore, it is necessary to identify possible characteristics of CSR expenditure instead of limiting it to a pre-set type of expenditure.

According to Kloppers and Kloppers (2017), a number of commonalities can be identified from a variety of international and local definitions:

- CSR should play an active role in addressing social needs and should contribute to sustainable development.
- CSR should benefit both business and society where the business can profit from doing good and operating responsibly in society (strategic CSR);
- CSR initiatives should be undertaken primarily to the benefit of previously disadvantaged communities or individuals; and
- businesses should contribute to transformation through CSR initiatives.

Based on these commonalities, this contribution supports the view that within the South African context, qualifying CSR expenditure should, in the first instance, be limited to those expenditures that provide the business with a strategic benefit whilst addressing social needs and benefitting underprivileged individuals or communities (Kloppers and Fourie 2014; Lantos 2001, 2003). The strong focus on transformation and benefitting previously disadvantaged communities or individuals, emanates from the BEE framework with its aim to involve the mentioned communities or individuals in the mainstream economy.

Although the current BEE framework does not refer to CSR, it does allude to a closely related topic: socio-economic development (SED), which is included in the BEE scorecards. In the context of the financial services sector, the draft amended Financial Sector Code (South Africa 2016: 125) states that the objective of SED contributions is the "promotion of sustainable access by beneficiaries to the economy". Furthermore, it identifies various programmes that may qualify for SED, for example, those focusing on education, training and job creation (South Africa 2016: 74). The draft code further identifies the following as possible SED contributions: grant contributions, direct costs incurred in assisting beneficiaries and contributions made to third parties that oversee SED on behalf of the business (South Africa 2016: 74–75).

Applied to the case study, the costs incurred by the insurance company could be classified as CSR expenditure. The company 'employs' people from disadvantaged communities, provide them with training and, in some instances, bursaries. Therefore, is clear that the initiative does address social needs and thereby contributes to economic transformation. The company could argue further that the initiative is strategic to its core business (by providing short-term insurance). If traffic is regulated and running smoothly, road accidents occur less frequently since motorists are not faced with the frustration of being held up in traffic. Fewer accidents are equal to less insurance claims, a situation that ultimately benefits the company's bottom-line (i.e. a highly strategic initiative). The expenditure associated with the initiative can be labelled as 'CSR expenditure'. However, whether the expenditure *in toto* can be claimed as a deduction for that purpose, is not that evident.

9.3 Deductibility of CSR Expenditure in Terms of Sections 11(a) and 23(g) of the ITA

9.3.1 General Deduction Formula

Certain sections in the ITA must be considered to determine whether, and to what extent CSR expenditure can be deducted from income. The primary sections are 11(a) and 23(g), where 11(a) identifies the amounts that may be deducted, and 23(g) which are prohibited. In terms of these sections only the following will be allowed as deduction against income: expenditure and losses actually incurred during the year of assessment in the production of income, which are not of a capital nature and are expended for the purposes of trade (Croome 2013: 129 et seq; Stighling 2018: 114–122 and 126–127; Venter 2015: 111–152; Williams 2006: 259–332).

When referring to the case study, it can be assumed that the company has an unconditional liability to pay the amount and has incurred this liability within the year of assessment. The question is not whether or not the CSR expenditure is necessary—the test is simply if the expenditure is actually incurred regardless of it being extravagant or unnecessary (*Port Elizabeth Electric Tramway Co Ltd v Commissioner for Inland Revenue* 1936 CPD 241, 8 SATC 13). This raises the relevant question in this context: Is the expenditure actually incurred *in the production of income* and *not of a capital nature* and *expended (in part or in full) for trade purposes*?

9.3.1.1 … In the Production of Income

In order to establish whether an amount was laid out in the production of income, the following details has to be the determined: Firstly, the purpose for which the expense was incurred (the action that gave rise to the expense); and secondly, whether the expense is linked closely enough (or related directly) with the production of income

(*PE Electric Tramway* 17). It should be noted that the expenditure need not produce income in the year in which the expense is incurred (Croome 2013: 144; *Sub-Nigel Ltd v Commissioner for Inland Revenue* 1948 (4) SA 580). According to Venter (2015: 123) in discussing *PE Tramway,* "it should be asked whether the expense is so closely connected with the income earned *that it may be regarded as part of the cost of performing it*" (emphasis added).

9.3.1.2 … Not of a Capital Nature

The ITA does not define the aspects of capital expenditure. Therefore, it is the prerogative of the judiciary to develop tests that determine the capital or revenue nature of specific expenditure. This includes the 'operations-vs-structure' test applied to establish whether the expenditure forms part of the income-producing operations or its structure (Croome 2013: 158–72; Stighling 2018: 121–122). If the expense is aimed at acquiring an income-producing concern then the expenditure will be of a capital nature (*BP Southern Africa v CSARS* 69 SATC 79 par 7; *CIR v George Forest Timber Co Ltd* 1 SATC 20). In *Commissioner for Inland Revenue v Pick 'n Pay Wholesalers (Pty) Ltd* (1987 (3) SA 453 (A)) at 455 the court stated that:

> Money spent as part of a long-term and ongoing business strategy to build up and maintain a particular image in order to create or sustain an income-producing concern must be classified as expenditure of a capital nature as envisaged by s 11(a).

The *Pick 'n Pay* case is of particular importance in the context of this research. The case focuses on the question whether a donation made to the Urban Foundation, an organisation focusing on social needs (esp. the improvement of housing) qualify as a deduction in terms of section 11(a) and the then section 23(g) which stated that expenditure should only be deductible if "wholly or exclusively laid out or expended for the purposes of trade". The donation was made "to 'promote the image' of respondent as a socially responsible company and to secure publicity for itself in order to protect such image" (*CIR v Pick 'n Pay* on 455B). The action was undertaken with a business objective in mind and resulted in a business advantage—the production of income (*CIR v Pick 'n Pay* on 456J & 459C). The court concluded that "the expenditure was aimed at neither establishing nor extending the business" and thus was deemed not of a capital nature (*CIR v Pick 'n Pay* on 459H). Based on the facts before it, the court ultimately concluded that the donation was not deductible since it was made in terms of both a philanthropic and a business purpose (*CIR v Pick 'n Pay* on 471E). Williams (2014: 522) notes that since the ITA has been amended to exclude the 'wholly-or-exclusively' requirement, the part of the donation incurred in the production of income will be deductible—provided it adheres to all requirements.

Another test examines the extent to which the incurred expenditure has created an asset or advantage for the enduring benefit of the trade. Courts have also developed the 'fixed-vs-floating capital', 'once-and-for-all' expenditure and 'nature-of-the-business' tests (Venter 2015: 135). Despite the various tests that were developed, it should be noted that expenses incurred were to be examined in the context where it occurs and the true nature of the expense thus established.

If the case study is considered in this context, it is clear that an amount of its expenditure was incurred to improve the company's brand through advertising (the branded motorcycles and bright vests)—despite the fact that it also had a purpose of demonstrating socially responsibility. In other words, this will result in a business benefit without establishing or extending the business. As a result, this expenditure will not be of a capital nature and will be deductible to the extent that it is expended for trade purposes.

9.3.1.3 … For Trade Purposes

The ITA gives an expansive definition of trade. According to this section, trade include any profession, trade, business, employment, calling, occupation or venture. If amounts are not laid out for trade purposes, such expenditure will not qualify as deductible expenses. It is, furthermore, not necessary that the amounts should be expended fully or exclusively for trade purposes. The effect of this position is that if expenditure is made with a dual purpose in mind, the part of the expenditure related to trade will be tax deductible, while the same will not apply to the other part It may, however, be a more difficult undertaking to determine within the context of the case study which part of the expenditure is laid out for trade purposes and driven purely by commercial motives; and which part of the expenditure does promote the company as a socially responsible organisation.

9.3.2 Specific Case Law

This section will reflect briefly on instances where decisions were reached on tax deductibility of matters that can be coined as 'CSR expenditure'.

9.3.2.1 Warner Lambert SA (Pty) Ltd v Commissioner, South African Revenue Service

The issue of the deductibility of explicit CSR expenditure has only once come before the courts for adjudication—in *Warner Lambert SA (Pty) Ltd v Commissioner, South African Revenue Service* (2003 (5) SA 344 (SCA)). In this case, the court had to rule on the question whether or not social-responsibility expenditure, in terms of foreign legislation, incurred in South Africa by a subsidiary of a foreign company, qualified as deductions in terms of sections 11(a) and 23(g) of the ITA. The parent company of the appellant as well as the appellant itself were signatories of the Sullivan Principles which were one of the first CSR instruments. The Principles were aimed specifically at USA companies trading in the then apartheid South Africa and predominantly addressed issues related to fair and equal labour practices such as equal pay and the development of training programmes. Furthermore, under the US *Comprehensive Anti-Apartheid Act* the American parent companies were obliged to ensure that their South African subsidiaries complied with the Act. Failure to comply would result in fines in the USA and even the possibility of imprisonment for directors (*Warner* on 349D).

In compliance with the seventh principle of the Sullivan Code and the *Comprehensive Anti-Apartheid Act* the appellant incurred expenses in an attempt to eliminate laws and customs that impede social, economic and political justice. The appellant alleged that it would have been detrimental to its business if it had not incurred the expenses. For example, their company may have lost its privileged subsidiary status and other trade advantages. The court found that in this instance it was unthinkable that the appellant should not comply (*Warner* on 352I) and that the Sullivan Code expenses were:

> *[B]ona fide* incurred for the performance of the appellant's income producing operation and formed part of the cost of performing it. The social responsibility expenditure was therefore incurred for the purposes of trade and for no other. (*Warner* on 353B)

Appellate judge Conradie noted that these payments had been made in order to ensure that the appellant would be able to continue with its trade and to preserve the business from harm or at least to avert the risk of damage (*Warner* on 353F). Consequently, he equated the payments made to insurance premiums, which are deductible expenses since it was aimed at protecting the income-earning structure of the business.

The court concluded that the expenditure related to equal pay, the development of training programmes or improving the quality of employees' lives outside the work environment, were undoubtedly deductible.

On the other hand, and the expenses related to 'Working to Eliminate Laws and Customs that Impede Social, Economic, and Political Justice' posed more of a challenge (*Warner* on 349G-I). However, the court found the purpose of *all* the Sullivan Code expenditure, was to "insure against the risk of losing its treasured subsidiary status" (*Warner* on 352F). It was laid out in performing the taxpayer's income-producing operation. Therefore, it formed part of the operational costs and was incurred for the purposes of the taxpayer's trade (*Warner* on 353A). The contentious expenditure was not laid out as a result of disinterested benevolence, but ultimately was inextricably linked to the business's trade. The income-earning structure of the taxpayer was well established and the expenditure did not create a new asset. This fact led the court to conclude that the expenditure was in nature revenue and thus deductible (*Warner* on 353B-G).

In a discussion of the case, PWC (2004) submitted in conclusion that this case

> shows the subtle infusion of the underlying values of the Constitution, even into arid and technical reaches of tax law in leading the court in the direction of the view (not yet fully articulated or embraced) that expenditure on "social responsibility" projects is an ordinary incident of a trader's revenue expenses, in the sense that it is expenditure of a kind that the community expects businesses to incur, and that consumers would tend not to patronise businesses that do not incur such expenditure.

Significantly, the above-mentioned article noted that, based on the *Warner* judgment, the next question in tax jurisprudence to answer may relate to BEE, where expenditure is made in order to achieve a favourable rating in terms of the BEE scorecard. In this case there is no "statutory compulsion" and a "tenuous link to the production of income" (PWC 2004). SARS was called upon to answer this query in 2009 in the second Binding Class Ruling.

9.3.2.2 Binding Class Ruling: BCR 002

The central issue at hand in the *Warner* case was business expenses incurred in order to retain a 'license to operate'. This issue was dealt with in a SARS Binding Class Ruling (BCR). A Binding Class Ruling is in essence similar to a Binding Private Ruling but is applicable to a class of persons as defined in the ITA. It is intended to promote clarity, consistency, and certainty in respect of the interpretation and application of the tax laws to a specific class of persons. A class member is a member of the Class to which the Binding Class Ruling applies such as legal entities or a shareholder in a company or an employee participant in a share investment scheme (SARS 2016). A BCR binds the Commissioner only in respect of the specific class of persons identified in the ruling and is governed by section 76E of the ITA.

On 12 May 2009, SARS released *Binding Class Ruling: BCR 002* (Gaum 2010; SARS 2009) that addresses the issue of expenditure incurred on CSR programmes. Although the ruling applies only to the applicant, namely a South African resident holding company and its wholly owned subsidiaries, it does provide valuable insight into SARS's possible future approaches towards certain CSR expenditure. The ruling related specifically to CSR expenditure made to socio-economic development in terms of the BEE Generic Scorecard.[1] In order to achieve the maximum amount of points for the socio-economic development scorecard, a business must spend at least 1 per cent of its net profits after tax on socio-economic development. Thus, to comply with this requirement the executive committee of the applicant decided to contribute to socio-economic development through "the provision of bursaries to needy recipients from underprivileged backgrounds to be used by them for the payment of fees for schooling" (SARS 2009 par 6). The costs of the bursaries, which would be incurred for the purposes of earning BEE-scorecard points, will qualify as a deduction under the ruling in terms of sections 11(a) and 23(g). The deduction will be allowed only if the company in the group claiming the expenditure actually carried on a trade and if the expenditure was incurred by a company in the group for its own empowerment rating. The BCR was valid for a period of five years from 28 August 2008.

This ruling confirms the approach followed in *Warner*. In summation it can be stated that where businesses incur CSR expenses aimed at achieving a certain BEE

[1]For a complete discussion of the socio-economic development element of the BEE scorecard, see Kloppers, *Improving land reform through CSR: A legal framework analysis* (unpublished LLD thesis, NWU, 2012) 281–283.

rating, such expenses will be deductible if the taxpayer conforms to the requirements of sections 11(a) and 23(g). This position was re-affirmed in Binding Private Ruling: BPR 113, according to which SARS confirmed that an investment of annual turnover into selected emerging BEE vendors would qualify for a deduction under sections 11(a) and 23(g). However, businesses should take note of the warning issued by Ernst & Young (2011).

> These days most companies incur CSR expenditure and often companies automatically treat all of these expenses as tax deductible without proper consideration of the merits for that treatment. Companies should be aware of the various ways in which CSR expenditure can be treated for tax purposes and should ensure that proper controls are in place to maximise the tax deductibility of their CSR expenditure and avoid the deduction (with resulting penalties) of amounts which do not qualify.

This statement elucidates the "various ways in which CSR expenditure can be treated for tax purposes" which implies that businesses do have alternative avenues to explore if their expenditure does not meet the criteria as set out in sections 11(a) and 23(g). The following paragraphs will explicate a number of these avenues.

9.4 CSR Contributions Through PBOs

9.4.1 Introduction

Taxpayers are at liberty to structure their tax affairs in such a manner as to receive the maximum benefit and pay the minimum amount of tax due. This is provided that the structure falls within the confines of the current tax framework and is not subjected to the anti-avoidance measures laid down in, for example, sections 7 and 80A-L of the ITA. This section will examine whether including Public Benefit Organisations (PBOs) in a tax structure to drive a business's CSR initiatives provides any notable tax benefits with reference to its CSR expenditure.

Meaningful engagement in CSR initiatives requires research and planning—which requires time and resources. Unfortunately, in most instances businesses do not have the know-how and expertise to drive successful CSR programmes (but do have funding available). As a result, this function is outsourced to organisations specialising in this area. These organisations could either be totally independent (serving a variety of corporate donors), or could be created by a single business to carry out its particular CSR programmes while receiving donations from the specific business. These organisations need to be approved PBOs in order to receive the tax benefit regarding the deductibility of donations to certain organisations in terms of section 18A of the ITA which is discussed later in this article (SARS 2016). The following paragraph will provide a brief overview of the requirements as set out in section 30 of the ITA.

9.4.2 PBO Requirements

With reference to PBO's Williams (2014: 503) states that

> [t]he Income Tax Act is highly prescriptive as to the criteria in terms of which approval is granted for tax exemption under this provision and in regard to the ensuring compliance obligations.

A PBO is a non-profit company registered in terms of the Companies Act (South Africa 2008); trust or association of persons with the sole or principal object to perform one or more public benefit activities listed in Part 1 of the Ninth Schedule to the ITA. These activities must be performed in a non-profit manner with an altruistic or philanthropic (benevolent) intent without promoting the economic self-interest of any fiduciary or employee of the organisation (ITA section 30(1)(a) & (b)). Williams (2014: 498) notes that the non-profit requirement ensures that PBOs "do not exploit their tax-exempt status to engage in extraneous commercial activities and thereby earn undeserved tax-free income."

According to SARS (2014a)

> the mere fact that an organisation has a non-profit motive or is established or registered as an NPO under the Nonprofit Organisations Act 71 of 1997 (NPO Act), or is established as a non-profit company under the Companies Act, does not mean that it automatically qualifies for preferential tax treatment or approval as a PBO. An organisation will only enjoy preferential tax treatment after it has applied for and been granted approval as a PBO by the TEU and continues to comply with the relevant requirements and conditions as set out in the Act.

The public-benefit activity (PBA) undertaken by the PBO should, in terms of section 30(1)(c) of the ITA, be available to the general public, including any sector thereof, but excluding small and exclusive groups. It is evident that identifying the particular PBA is central to the existence of a PBO. Part 1 of the Ninth Schedule identifies ten categories of public benefit activities. These categories include: welfare and humanitarian; health care; education and development; culture and sport. Each of these categories identifies specific activities within its scope. For example, the category 'welfare and humanitarian' refers to "community development for poor and needy persons and anti-poverty initiatives" while the 'education and development' category refers to "training for unemployed persons with the purpose of enabling them to obtain employment", as well as "the provision of scholarships, bursaries …" (ITA, Schedule 9: par 1(p); 4(e) and 4(o).)

In order to be approved as a PBO, the organisation has to provide evidence to the Commissioner of SARS that its resources will be used to further the identified PBA (or its activities). This evidence can be provided through, inter alia, the constitutive document of the organisation. This document, depending on the type of organisation, could either be the statutes of the company, a will or other written documents in line with the organisation's constitution (ITA section 30(3)(a) & (b)). Section 30(3)(b) identifies specific content that has to be included in the constitutive document. In addition, at least three unconnected individuals should assume the fiduciary responsibility for managing the organisation, and the distribution of funds should only be mandated to achieve the objective of the organisation. Crucially, the document should also state that the organisation is:

> prohibited from accepting any donation which is recoverable at the instance of the donor for reasons other than a material failure to conform to the designated purposes and conditions of such donation, including any misrepresentation with regard to the tax deductibility thereof in terms of section 18A. (ITA s 30(b)(v)).

The Commissioner—and especially the Tax Exemption Unit on behalf of the Commissioner—should be satisfied that the requirements have been met and that the organisation does not form part of an illegitimate tax-avoidance structure. If satisfied the Commissioner will grant approval for the organisation after which the PBO will receive beneficial tax treatment for the duration of its compliance with the requirements. The qualifying PBO will be exempt from normal tax in terms of section 10(1)(cN) of the ITA which exempts, from normal tax liability, receipts and accruals derived through a means other than from a business undertaking or a trading activity (SARS 2014b). Steenkamp (2014) identifies the following tax relief that applies to transactions involving PBOs: tax free donations to PBOs; no registration for provisional tax; no estate duty of bequests to PBOs; and VAT exemption for supplies of donated goods.

From the wording of section 30(1)(b), two interesting issues can be raised. Firstly, sub-section (i) states that the PBO should be a not-for-profit organisation with an altruistic or philanthropic intent. The sub-section refers to the intent with which the PBO must carry out its PBA, namely philanthropic or altruistic. Secondly the focus is solely on the intent of the PBO, and not that of the parties donating to the PBO. Thus the PBO should be seen focusing on charitable activities where financial gain for the PBO (or its fiduciary or employee, as per sub-section (ii)) is excluded. However, section 30 places no such limitation on the donor. It would, therefore, appear that a business can make a 'strategic contribution' to a PBO where the donor receives a 'spin-off' (or indirect benefit) from the donation. For example, in the *Pick 'n Pay* case, the spin-off, which the company received in return for its donation to the Urban Foundation, was indirect marketing which promoted the brand as a socially responsible company. With regard to the mentioned case study: The insurance company may make an annual donation to a PBO aimed at training unemployed persons and thus enabling them to obtain employment, or for a community-based anti-poverty initiative aimed at empowering poor and needy persons. In these cases, a donation would receive beneficial tax treatment, whilst at the same time benefitting a sector of the general public.

Returning to the case study, the insurance company donates brightly coloured vests branded in the company's logo to an approved PBO, thereby providing training to points-persons who are unemployed. Hence, it is likely that the company's brand will be enhanced—commuters will observe the points-persons wearing the branded vests, and in all likelihood will remember the brand when they consider new insurance, thus providing the company with a strategic benefit. The same situation applies to the donation of brightly coloured, branded motorcycles donated to the PBO.

Thus, the financial bottom-line is used to decide whether or not to expend funds on CSR initiatives, or donate to a PBO responsible for CSR-related initiatives. Therefore, it falls to be determined whether the expenditure or donation is tax deductible or not. The following section examines the position regarding the deduction of donations to organisations in terms of section 18A of the ITA.

9.5 Section 18A Donations

Section 18A of the ITA regulates the deduction of donations made to PBOs and qualifying beneficiaries (Stighling 2018: 159–164). A donation is defined in section 55(1) of the ITA as a "gratuitous disposal of property, where property includes any right in or to moveable or immovable, corporeal or incorporeal property". The donation should be motivated by "pure liberality" or "disinterested benevolence" (*CSARS v Estate Welch's* 66 SATC 303; Stighling 2018: 907). Sub-section 18A(1) stipulates the following:

"Nothwithstanding the provisions of section 23, there shall be allowed to be deducted from the taxable income of any taxpayer so much of the sum of any *bona fide* donations by that taxpayer in cash or of property made in kind, which was actually paid or transferred to –

(a) any –

i. public benefit organisation contemplated in paragraph (a)(i) of the definition of 'public benefit organisation' in section 30(1) approved by the Commissioner under section 30; or ….
Which –

(aa) carries on in the Republic any public benefit activity contemplated in Part II of the Ninth Schedule….

As does not exceed –

…

(c)(B) in any other case, ten per cent of the taxable income … as calculated before allowing any deduction under this section."

Section 18A provides for the deduction of amounts which, in the absence of this section, would have been specifically prohibited in terms of section 23. Contrary to section 11(a), which only refers to expenditure actually *incurred* (unconditional liability), section 18A stipulates that the donation should actually have been *paid*—thus not simply an accounting exercise. It should be noted further that this section refers to the activities with public benefits referred to in Part II of the Ninth Schedule, while section 30(1)(a) which defines a PBA within the context of approving a PBO, refers to Part I of the same Schedule. The scope of Part II of the Schedule is limited to only five categories of activities, as opposed to the 10 categories in Part I. The following public-benefit activities are not included in Part II: those related to religion, belief or philosophy; culture; research and consumer rights; and sport. Therefore, any donations made to PBOs that focus on these categories will not be regarded as a qualifying payment under section 18A.

Should the requirements set out in section 18A(1) be met, the taxpayer (excluding a portfolio of a collective investment scheme) may deduct up to a maximum of 10 per cent of its calculated taxable income before allowing any deduction under the mentioned section. If a donation exceeds the 10% ceiling; the excess amount can be carried over as a deductible donation in the following year of assessment (s18A(1)(B) of the ITA). With regard to the case study: if the insurance company has a taxable income of R100 million, in terms of this section it could make a donation of R10 million to the approved PBO and receive the full tax benefit of the donation. Making use of such a deduction enables the taxpayer to lower its tax liability effectively while addressing societal needs by its commitment to CSR.

Noticeably, a claim for deduction in terms of this section will only be allowed if it is supported by a receipt issued by the donee PBO. The receipt should contain specific details: the name; reference number (issued by the Commissioner) and address of the PBO. It should also stipulate the date of the donation; the name and address of the donor; and the amount of the donation, The receipt should also include: "a certification to the effect that the receipt is issued for the purposes of section 18A … and that the donation has been or will be used exclusively for the object of the public benefit organisation … in carrying on the relevant public benefit activity …" (section 18A(2)(a) of the ITA).

The PBO furthermore should only issue the tax deduction certificate if the donation is intended to be used solely in pursuance of the public-benefit activities identified in Part II of the Ninth Schedule (section 18(A)(2A)(a) of the ITA). This fact should be confirmed annually through an audit certificate.

The use of donations to PBOs as strategy to lower business' annual tax liability does not amount to an unacceptable tax practice or tax scheme (provided that the requirements set out in the previous two paragraphs are met). However, this practice does bring to the fore an established objection to businesses spending on 'non-core activities'.

9.6 Spending on Non-core Activities

Within the context of CSR, the above-mentioned objection was identified by Friedman (1970). In his seminal article—which represents a reaction to the views of proponents of CSR, such as Davies (1960: 70–76)—Friedman argues that the exclusive responsibility of a business manager (and thus the business) is towards his/her employers, and ultimately the shareholders. This responsibility is normally to produce as much income as possible and generate profits, within the boundaries set by law and ethical custom. The manager thus acts as an agent of the shareholders, who are regarded as being the principal in the principal-agent relationship. The pursuit of profit maximisation for the shareholder forms the focal point of this approach (Van Marrewijk 2003: 96). In this sense, the company is regarded as an ‘economic agent’ with its primary objective to maximise profits (Husted and Salaza 2006: 80). Thus the manager should ensure that the economic value of the business is increased to the benefit of its shareholders.

The sole function of a business should thus be economic, where profit maximisation is the criterion used to measure success and Government is viewed as the only legitimate institution that should address social issues. In terms of this approach businesses should pursue only economic self-interest—any attempt to engage in CSR is morally wrong (Freeman and Liedtka 1991: 93).

In terms of the Friedman approach, those who support CSR are “preaching pure and unadulterated socialism” and CSR “involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses” (Freidman 1970). He further states that:

> Few trends could so thoroughly undermine the very foundation of our free society as the *acceptance by officials of a social responsibility* other than to make as much money for their stakeholders as possible (Friedman, quoted by Caroll 1999: 277, emphasis added).

The Friedman approach to CSR is summarised aptly:

> There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud (Friedman 1970).

This approach accordingly rejects *discretionary* expenditure on CSR and regards the creation of economic wealth as the most important contribution of the private sector towards general welfare (Windsor 2006: 103). It also supports the notion that wealth creation should be the supreme goal of business and that this goal is best achieved by conducting a business for self-interest. This implies that business should confine itself to its commercial role (Cannon 1994: 36; Crane et al. 2008: 60). According to this rationale, it is argued that wealth creation further supports the national treasury by levying taxes. Increased wealth should lead to the collection of more taxes collected, which government could utilise to address social problems.

In accordance with Friedman’s approach it can be argued that taking on social responsibilities distorts the market and interferes with the economic activities of firms, while enabling governments to escape the obligation to fulfil their responsibilities towards citizens. Governments are likely to neglect their responsibilities if those are taken over by the private sector. “Unnecessary expenditure” on CSR initiatives can be regarded as a misappropriation of valuable corporate resources that should either be directly re-invested in the business, or paid out to the shareholders. The mere fact that a business enterprise provides employment and pays taxes is enough to prove that the private sector is accepting their social responsibility.

Applying the above exposition to the case study, it may be argued that, on the one hand, the company will pay more taxes (due to non-compliance to the section 18A-donation). However, the nett result will be an increased profit margin (since there is no CSR expenditure of R10 million), which ultimately will benefit the shareholders.

Fortunately for the millions of beneficiaries of CSR initiatives, Friedman's school of thought is no longer the established theoretical underpinning of CSR. Conventional wisdom has expanded to be more stakeholder-oriented instead of focusing exclusively on profits and shareholders. It is accepted generally that the business case for CSR has been established. Therefore, businesses engaging in CSR initiatives receive financial benefits from these initiatives over the long term. Within the context of the case study, it has been mentioned that the insurer may gain an enhanced company image and reputation due to its CSR initiative. Through its spending on CSR the insurance company is 'doing well by doing good.'

Finally, on the topic of donations it should be mentioned that if the donation made by a donor other than a natural person is not specifically exempt (e.g. in terms of section 18A of the ITA), the amount in excess of R10 000 will, in terms of section 56(2)(a), be subject to 20 per cent donations tax. This expenditure of R10 000 is limited further to casual gifts (Stiglingh 2018: 912). Therefore, if a business makes a donation to a non-exempt PBO, the expenditure would be subject to donations tax at the prescribed rate and the business would receive no tax benefit. In such an instance the business would be better suited to address its CSR activities 'in-house' and attempt to gain a tax deduction by complying with sections 11(a) and 23(g).

9.7 Conclusion

This contribution pointed out that the ITA makes no reference to or special provision for CSR expenditure being deductible in terms of the Act. The issue of deductible expenditure is addressed in section 11 of the Act, with section 11(a) indicating which expenditure would be deductible when determining a taxpayer's liability. Only expenditure and losses actually incurred in the production of income will be allowed as a deduction against gross income, provided that it does not entail capital expenditure and losses. In order to qualify as a deduction, section 23(g) of the Act requires the expenditure to be laid out or expended *for the purposes of trade*. Accordingly, in order for a taxpayer to claim CSR as deductible expenditure, it has to be demonstrated that the expenditure was trade related and actually incurred in the production of income.

The following examples will elucidate the above-mentioned issue. If, for example, the insurance company in the case study directs finances to purely philanthropic purposes, SARS would in all likelihood not allow the deduction if it is not trade-related and incurred in the production of income. For the same reason of non-compliance, should the insurance company make a donation to a home for seniors, the expense will not qualify in terms of s11(a) and 23(g). This expenditure may be regarded as a donation, for which the company might even be liable to pay donations tax if the recipient is not registered as a public benefit organisation (PBO). If, however, the same company lays out money in order to gain points on the company's BEE scorecard the link between trade and income production may be sufficient to satisfy the requirements of the Act, seeing that it is incurred for the purposes of the taxpayer's trade in the production of future income and is not of a capital nature.

If it is accepted that CSR expenditure should result in the improvement of society, the Government would be expected to grant a full income-tax deduction for this type of expenditure. Unfortunately, socially responsible expenditure is not incentivised through, for example, an enhanced recognition of the expenditure. This entails an instrument where the actual expenditure is multiplied perhaps by a factor of 1.5 in order to provide for a larger deductible sum. Neither can CSR be incentivised by providing an additional deduction beyond the normal deductibility. The current state of affairs is that businesses that consider incurring expenses related to (or labelled as) CSR should, due to the application of section 11(a) of the ITA, ensure that the expenses actually qualify as deductible expenditure. As an alternative, this article identified the use of a registered PBO as an avenue to explore in attaining a possible a tax benefit. By applying section 18A of the ITA, the taxpayer could make a donation to a qualifying PBO and deduct up to 10 per cent of its taxable income. As a result, the taxpayer in reality would be able to make a deduction, which would not typically be allowed in terms of the general deduction formula according to the Act.

In conclusion: corporates should not be deterred to contribute to CSR initiatives due to the fact that these contributions might not tax deductible in terms of the general deduction formula. This article identified donations to a registered PBO as a viable alternative which if structured correctly could provide a significant tax deduction. Corporates should be encouraged to consider this as an alternative to their current 'in-house' CSR expenditure.

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Chapter 10
Corporate Social Responsibility and the Role of Government

Anupama Goel

Abstract Historically, corporate culture is focused on the maximisation of wealth with little emphasis on the means of achieving it. That culture has undergone a transformation with the advent of the corporations being encouraged to participate in allowing their profits to percolate to the other classes of society. Simply stated and understood, corporate social responsibility entails business and corporate houses, which generate and hold wealth, to be responsible and accountable for investing a part of their profits towards the larger good of the society. More recently, however, it has been interpreted as a continuous commitment and responsibility, where apart from spending a portion of profits, companies must attempt and concentrate on earning money in a more responsible way. This is now considered as a fundamental and essential requirement of corporate social responsibility and is much wider than the traditional notion of merely sharing a piece of the cake with the rest of the society. Including social issues into the corporate strategy and caring for them is now the hallmark for an innovative and dynamic CSR. With crony capitalism having been recognised to be as undesirable as communism, and the emphasis across the globe have moved to a more nuanced and mixed nature of economy and corporatisation, CSR has assumed centre-stage. This is more so in developing economies like ours, where no-one can afford to completely overlook the teeming millions. Although traditionally, the State was envisaged to be merely an entity for ensuring law and order and performing police functions, our Constitution envisages a much larger role for the State and mandates the State to engage in activities for the overall welfare of the people. Similarly, the State needs to ensure that the traditional corporate notion of maximisation of wealth is abandoned, and corporate entities indulge in participating with the rest of the society—to identify the social ills, to create awareness about them, and to take meaningful steps for removing these social problems. The present paper is an attempt at identifying and comparing the various ways of Governmental regulation on corporate behaviour for promoting corporate social responsibility. Following are some jurisprudential questions, which need to be pondered upon—Can business/corporate houses absolve from their social and environmental responsibilities

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by merely sharing or donating a part of their profits, when the cost of human and environmental resources, which they utilise is far heavier? Can there be some legal and regulatory mechanism imposed on a venture before it starts, which is anticipated to cause some environmental change or threaten some social displacements etc.? What can be the precise role of the government and its regulatory agencies to inculcate CSR in all business/corporate houses from the very inception, considering it as their basic obligation?

Keywords Government · Corporate · State · Society · Business · Responsibility · Policy · Public · Project · Programme · Economy

Opening statement
"When we want to help the poor, we usually offer them charity. Most often we use charity to avoid recognizing the problem and finding the solution for it. Charity becomes a way to shrug off our responsibility. But charity is no solution to poverty. Charity only perpetuates poverty by taking the initiative away from the poor. Charity allows us to go ahead with our own lives without worrying about the lives of the poor. Charity appeases our consciences."[1]

10.1 Introduction

Corporate Social Responsibility, the concept which started as charity or volunteerism or as a mere philanthropic gesture has been incorporated as a governmental policy by the majority of nations entails that the business and corporate houses, which generate and hold wealth, to be responsible and accountable for investing a part of their profits towards the larger good of the society. More recently, however, it has been interpreted as a continuous commitment and responsibility, where apart from spending a portion of the profit, companies must attempt and concentrate on earning money in a more responsible way. This is now considered as a fundamental and essential requirement of Corporate Social Responsibility (hereinafter CSR) and is much wider than the traditional notion of merely sharing a piece of the cake with the rest of the society. Including social, economic and environmental issues into the corporate strategy and caring for them is now the hallmark for an innovative and dynamic CSR. The corporate culture, which used to focus on the maximisation of wealth with little emphasis on the means of achieving it, has undergone a transformation with the advent of the companies being encouraged to participate in allowing their profits to percolate to the other classes of society. With crony capitalism having been recognised to be as undesirable as communism, and the emphasis across the globe have moved to a more nuanced and mixed nature of economy and corporatisation, CSR has assumed centre-stage. This is more so in developing economies like ours, where no-one can afford to completely overlook the teeming millions.

[1] Yunus, Banker to the Poor (2003).

Although traditionally, the State was envisaged to be merely an entity for ensuring law and order and performing police functions, our Constitution envisages a much larger role for the State and mandates the State to engage in activities for the overall welfare of the people. Similarly, the State needs to ensure that the traditional corporate notion of maximisation of wealth is abandoned, and corporate entities indulge in participating with the rest of the society—to identify the social ills, to create awareness about them, and to take meaningful steps for removing these social problems.

The present paper is an attempt at identifying and comparing the various ways of governmental regulation on corporate behaviour for promoting corporate social responsibility. Following are some of the jurisprudential questions, which need to be pondered upon:

- Can business/corporate houses absolve from their social and environmental responsibilities by merely sharing or donating a part of their profits, when the cost of human and environmental resources, which they utilise is far heavier?
- Can there be some legal and regulatory mechanism imposed on a venture before it starts, which is anticipated to cause some environmental effect/change or threaten some social displacements etc.?
- What can be the precise role of the government and its regulatory agencies to inculcate CSR in all business/corporate houses from the very inception, considering it as their basic obligation?

10.2 Corporate Social Responsibility—History, Concept and Standards

History of Corporate Social Responsibility seems to have started with the emergence of corporations in societies. French philosopher Rousseau has conceptualized the theme of CSR as 'symbiosis' i.e. the contract between business and society, which means co-living and co-existence for the mutual benefit.[2] According to him, it is a social contract arrived at by general will of the society (*volonte generale*), whereby society authorises organizations or corporations to use its land and resources as its agents and helps in improving the quality of life of society by offering employment along with various products and services.[3]

Adam Smith, an 18th-century economist and author of *the Wealth of Nations*, is often viewed as the father of modern capitalism. He talks about 'perfect markets' and 'invisible hand,' which is the core perception connecting the social responsibility of business with the performance of markets.[4] His three main underlying concepts are the 'invisible hand,' that individuals pursuing their own best self-interest would result in the greatest overall good to society, and that levels and kinds of goods and services

[2]Rousseau (2003).

[3]Ibid.

[4]For details see, Bichta (2003).

in the market should be determined by the free market alone (i.e., not by government).[5] People essentially vote with their dollars and they usually buy according to their needs and preferences i.e. the invisible hand would guide the suppliers in the marketplace to provide those goods and services which are required or sought for. The second notion is that each one would work hard, and as a result, society as a whole would benefit with more jobs, more competition, and better quality goods and services, i.e. while seeking his/her own best self-interest, every individual is actually doing the best thing that can be done for society, indicating Smith's belief regarding sufficient motivation for personal gain. The third notion effectively means that government should stay out of the market, and limit their role to police. Bill Gates called Adam Smith as 'the father of capitalism', who believed strongly in the value of self-interest for society and praised the impulse to altruism. Society needs both, and this is where creative capitalism comes in. Its aim is to marry sentiment and self-interest; to unite, as it were, the two Adam Smiths.[6] Smith believed that most people are self-interested, sympathetic, and wish to be well thought of. Successful commercial societies are built on these traits. The question is, how can they best be combined? In modern terms, how can institutions and incentives shape, channel, and balance these sometimes conflicting instincts to promote greater peace and prosperity? This was the subject of his two books, Competition disciplines producers (book titled *The Wealth of Nations*); Commercial interaction nurtures propriety and prudence (another book titled *The Theory of Moral Sentiments*). Two different perspectives have been given, but by no means contradictory. Smith also acknowledged the concept of externalities (mercury emissions, DDT, polychlorinated bi-phenols, stillbirths, cancer, and other disease caused by, but not paid for by, a business seeking its own self-interest) and other free-market breakdowns, but didn't really address them as a major challenge to the society.[7]

Adam Smith could have been right in those times, as there were less than one billion people on the planet, and the concept of externalities would have been foreign even to the most progressive economists. Later, Joseph Stiglitz, a modern Nobel Prize-winning Economist, said, "Whenever there are externalities–where the actions of an individual have impacts on others for which they do not pay, or for which they are not compensated–markets will not work well." Oliver Sheldon recommended to economise the use of resources and to use and combine them efficiently, so as to earn profits to continue operability and expand into new markets. Through the ethic of economising, by raising ethical standards and justice in the society, wealth increases in the society along with raising the standard of living whilst retaining a satisfactory level of profit.[8]

American scholars are also of the view that the corporate social responsibility refers to the responsibilities or the obligations for the society in the process of pursuing profit maximization or management in order to achieve the sustainable

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[5]Cooney (2012).

[6]Ibid.

[7]Ibid.

[8]*Supra* note 5.

development of the enterprises ultimately. The specific performance includes that the interests of enterprises' own interests, interests of investors or of the other groups, closely connected with corporations are considered appropriately. Apart from that, the bad effects for others should also be taken care of, such as the public nuisance, environmental pollution, waste of resources and so on. Enterprises must consider these problems when making decisions and take proper measures to avoid them as the performance of assuming social responsibility. Measures to protect and promote social welfare actions have also come under the obligations of the enterprises. According to Jones Mark Gui, corporate social responsibility has many types of responsibilities, apart from economic and legal obligations. In the United States, social responsibility always displays in the activities of enterprise's charity and donations and so on, corporate social responsibility also makes moral responsibility as the foothold.[9]

Therefore, CSR originated as an attempt to link society and business, to identify and integrate business with the stakeholders. In the 1960s, Keith Davies argued that CSR refers to 'the firm's consideration of, and response to, issues beyond the narrow economic, technical and legal requirements of the firm.'[10] Frederick stated 'social responsibility means that businessmen should oversee the operation of an economic system that fulfils the expectations of the people and this means in turn that the economy's means of production should be employed in such a way that production and distribution should enhance total socio-economic welfare.'[11]

In the 1980s, a well-established concept of CSR emerged which encompasses economic, social, legal, ethical and discretionary (philanthropic) expectations that society has of the organisations/corporate at a given point of time.[12] After United Nations Conference on Environment and Development (UNCED), 1992 held at Rio de Janeiro, Brazil emphasized the need for integrating environmental protection with socio-economic development, CSR came to include companies committed to work in a sustainable manner while keeping a check on environmental concerns for the long term benefit of all.[13] After tragic and much publicized and reported incidents of Bhopal Gas Leak in 1984 and Exxon Valdez oil spill in Alaska in 1990, in which huge damage occurred to both persons and property, environmental issues got prominence worldwide and became indispensable for any corporate to

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[9]The Definition and Characters of Corporate Social Responsibility. Retrieved from https://skemabest.wordpress.com/the-definition-and-characters-of-corporate-social-responsibility/.

[10]Davies (1973).

[11]Frederick (1960).

[12]Carroll (1999).

[13]*The Rio Declaration On Environment And Development 1992.* Overview of Agenda 21 Section One: Social and Economic Dimensions: Making Decisions for Sustainable Development Calls On Governments To Create Sustainable Development Strategies to integrate social and environmental policies in all ministries and at all levels, including fiscal measures and the budget. Encourages nations and corporate enterprises to integrate environmental protection, degradation, and restoration costs in decision-making at the outset, and to mount without delay the research necessary to reckon such costs, to develop protocols bringing these considerations into procedures at all levels of decision-making. Retrieved from http://www.unesco.org/education/pdf/RIO_E.PDF.

overlook. Other areas of environmental concerns such as greenhouse emissions, ozone layer depletion, climate change etc. have also been given significance in the working of the corporate due to the prominence given by the environmental experts worldwide, therefore contemporary CSR places an overall obligation on business not to harm the ecosphere which has been explained by Des Jardins succinctly as—'the business activity would be considered as harming the ecosphere when it uses resources at unsustainable rates or creates wastes that cannot be absorbed by the system.'[14] Moreover, CSR reporting has become a recent requirement to show the transparent working of the corporate and to justify any privilege or advantage to be expected from the government and many corporates have adopted it voluntarily or even mandated by the governmental policies across the world.

Corporate Social Responsibility (CSR) is now a mainstream concern for most businesses and large organisations. Traditionally, CSR has been understood as a strictly voluntary, business-led practice and relatively little attention has been paid to how public policies interact with CSR. In fact, now the governments around the world are promoting, facilitating and shaping CSR, and increasingly do so on the international level too.

With the emergence of International organisations in the world especially after World-War II, and many written constitutions adopted by many countries in post-colonial era, the welfare and justice commitments towards society at large have come to the centre-stage and are pronounced in forms of human rights, health and safety standards, labour welfare and work-wage standards, essentiality of ensuring education for all, environmental, air, water pollution concerns etc. To illustrate few: **Universal Declaration on Human Rights adopted in 1948** enumerated 'minimum essential core of human rights for all' set standards and paved way for many international declarations and conventions laying down regulatory measures for the corporate houses worldwide. Companies began to integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.

Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises 2011 gave far-reaching recommendations providing principles and standards for responsible business conduct for the corporations working in or from the countries adhering to the OECD Declaration on International Investment and Multinational Enterprises.[15] According to OECD, Corporate responsibility involves the search for an effective 'fit' between businesses and the societies in which they operate.[16] United Nations considers it a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders.

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[14] Des Jardins (1998).

[15] OECD Guidelines for Multinational Enterprises are an annexe to the OECD Declaration on International Investment and Multinational Enterprises. These legally non-binding guidelines were initially adopted by OECD in 1976 and later revised in 1979, 1982, 1984, 1991, 2000 and 2011.

[16] Retrieved from https://mneguidelines.oecd.org/MNE-Annual-Report-2013-Summary.pdf.

United Nations "Protect, Respect, Remedy" Guiding Principles Framework for Business and Human Rights proposed by UN Special Representative John Ruggie (2012) contained a conceptual and policy framework intended to anchor the business and human rights debate. The Framework was based on three pillars: the State duty to protect against human rights abuses by third parties, including business, the corporate responsibility to respect human rights and lastly, the need for more effective access to remedies.[17] European Union considers it the responsibility of the enterprises for their impacts on society.[18]

International Organisation for Standardization (ISO) 26000:2010 intended to provide all types of organisations guidance concerning social responsibility on all core issues, but neither interpreted as "guidelines or standards' nor provide any basis for legal actions. It is intended to assist organisations in all the countries to operate in a socially responsible manner by taking into consideration societal, economic, environmental, legal, cultural, political and organisational diversity.[19] ISO 26000:2010 provides guidance to all types of organizations, regardless of their size or location, on:

- concepts, terms and definitions related to social responsibility;
- the background, trends and characteristics of social responsibility;
- principles and practices relating to social responsibility;
- the core subjects and issues of social responsibility;
- integrating, implementing and promoting socially responsible behaviour throughout the organization and, through its policies and practices, within its sphere of influence;
- identifying and engaging with stakeholders; and
- communicating commitments, performance and other information related to social responsibility.

It assists organizations in contributing to sustainable development. It recognizes that compliance with the law is a fundamental duty of any organization and an essential part of their social responsibility. In applying ISO 26000:2010, it is advisable that an organization take into consideration societal, environmental, legal, cultural, political and organizational diversity, as well as differences in economic conditions while being consistent with international norms of behaviour. It also provides organizations with guidance concerning social responsibility and can be used as part of public policy activities.[20]

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[17]Retrieved from http://www.ituc-csi.org/IMG/pdf/12-04-23_ruggie_background_fd.pdf.

[18]These legally non-binding guidelines were initially adopted by OECD in 1976 and later revised in 1979,1982, 1984, 1991 and 2000.

[19]Retrieved from http://www.iso.org/iso/catalogue_detail?csnumber=42546.

[20]ISO 26000: 2010: Guidance on Social Responsibility. Retrieved from https://www.iso.org/standard/42546.html ISO 26000:2010 is not intended to prevent the development of national standards that are more specific, more demanding, or of a different type. However, for the purposes of the Marrakech Agreement establishing the World Trade Organization (WTO), it is not intended to be interpreted as an "international standard", "guideline" or "recommendation", nor is it intended to provide a basis for any presumption or finding that a measure is consistent with WTO obligations.

Institute of Social and Ethical Accountability also provides for Account Ability's AA1000 series of standards, which enable organizations to become accountable, responsible and sustainable. It consists of the

i. AA1000 accountability principles (AP) standard
ii. AA1000 assurance standard (AS) standard
iii. AA1000 stakeholder engagement (SE) standard.

These standards have been formulated through a multi-stakeholder consultation process i.e. with enter-prises, governments and civil societies, all of them, who are going to be impacted and stand to gain. [21]

Account Ability's work is based on the AA1000 Series of Standards, which are founded on the Principles of:

(a) Inclusivity—People should have a say in the decisions that impact them.
(b) Materiality—Decision makers should identify and be clear about the sustainability topics that matter.
(c) Responsiveness—Organisations should act transparently on material sustainability topics and their related impacts.
(d) Impact—Organisations should monitor, measure and be accountable for how their actions affect their broader ecosystems.

AA1000AP (2018) is an internationally accepted, principles-based framework and guidance that organisations can use to identify, prioritise and respond to sustainability challenges to improve long-term performance.[22]

Social Accountability International (SAI): SA 8000 Standard is one of the world's first auditable social certification standard. It is based on ILO, UN and national law conventions, and adopts a management system approach in order to ensure that companies that adopt this approach also comply with it. This standard ensures the protection of the basic human rights of workers. The nine basic elements of this standard in-clude (i) child labour (ii) forced and compulsory labour (iii) health and safety (iv) freedom of association and the right to collective bargaining (v) discrimination (vi) disciplinary practices (vii) working hours (viii) remuneration (ix) management systems.[23]

Principle-based approach of doing business, socially responsible policies and corporate sustainability has been formulated in form 10 principles by the **United**

Further, it is not intended to provide a basis for legal actions, complaints, defences or other claims in any international, domestic or other proceedings, nor is it intended to be cited as evidence of the evolution of customary international law.

[21] AA1000 Accountability Principles 2018. Retrieved from https://www.accountability.org/wp-content/uploads/2018/05/AA1000_ACCOUNTABILITY_PRINCIPLES_2018_Single_Pages.pdf.

[22] Ibid.

[23] Social Accountability International. Retrieved from http://www.sa-intl.org/ According to SAAS, there are 695 facilities in India that have been accredited with this standard. Out of these, Aditya Birla Chemicals (India) Limited, Bhilai Steel Plant Steel Authority of India Limited, Birla Tyres, Dr. Reddy's Laboratories Limited and Reliance Infrastructure Limited figure prominently in the list of certified facili-ties within India.

Nations Global Compact (UNGC), which have been derived from various UN conventions such as the Universal Declaration of Human Rights, International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption. By incorporating these 10 Principles, companies by modifying their strategies, policies and procedures are attempting to set the stage for long-term success apart from upholding their basic responsibilities to people and planet for establishing a culture of integrity.

These 10 principles cover four broad areas:

- Human rights (Principles 1 & 2: Support and respect the protection of international human rights and ensure that business is not complicit with human rights abuses)
- Labour rights (Principles 3,4,5 & 6: Uphold the freedom of association and the effective recognition of the right to collective bargaining, elimination of all forms of forced and compulsory labour, effective abolition of child labour and elimination of description in respect of employment and occupation)
- Environment (Principles 7,8 & 9: Support a precautionary approach to environmental challenges, undertake initiatives to promote greater environmental responsibility and encourage the development of environmentally friendly technology)
- Governance (Principles 10: Work against corruption of all forms, including bribery and extortion).[24]

Therefore, it can be seen that the concept of CSR along with identifiable standards and clear mandate has become an essential requirement to be met, for all the enterprises and corporates established on the ethical grounds.

10.3 Corporate Social Responsibility: Legislative Mandate and the Role of Governments

Corporate Social Responsibility is a concept which deals with is the responsibility of the corporations operating within society to contribute towards economic, social and environmental development that creates a positive impact on society at large. The concept differs from basic philanthropy and charity where there is not much accountability or responsibility attached. Whereas CSR activities suggest that businesses cannot succeed in isolation, especially when society fails.

In India, the idea of CSR may seem new, but it has always found ingrained in ancient Indian jurisprudence, which used to have philanthropic connotations to it. Doing business, trade or commerce always carried with it ethical and moral responsibilities, without which it used to be thought that social and economic prosperity is not possible to achieve. An ideal CSR in India always meant the direct engagement of business in the mainstream social development, concern for vulnerable sections of

[24] United Nations Global Compact: The Power of Principles. Retrieved from https://www.unglobalcompact.org/what-is-gc/mission/principles.

society, the welfare of workers and their families, congenial working conditions at the workplace, proper profit sharing, care for mother earth and environment, temples, schools and hospitals for workers and others etc. This used to be considered as a divine obligation to share with the poor and vulnerable sections of the society and consider water bodies, rivers, earth and other natural resources as divine bounties to be preserved and conserved for the whole of mankind.[25]

After independence, the need to achieve and ensure CSR through governmental intervention was felt in India also. Government of India (hereinafter, GOI) also started persuading and coaxing companies to participate in addressing social, developmental and environmental issues. The Department of Public Enterprises (DPE) issued guidelines for companies to assist in ensuring towards achieving inclusive growth and to assist in environmental protection and imperatives of climate change. These guidelines have been issued primarily for compliance by Central Public Sector Enterprises (CPSEs), so as to make them more transparent, accountable and responsible for various stakeholders in the society, by providing safe and sustainable goods and services. Businesses also started feeling the need to support inclusive growth and equitable development which includes ensuring the welfare of employees, providing value to customers, respect and promotion of human rights along with making efforts to restore and maintain environment. Ministry of Corporate Affairs National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business laid emphasis on engaging public and private companies to enhance their contributions towards reducing social and economic disparities in the country. In 2010, Department of Public Enterprise (DPE), Government of India introduced 'mandatory' CSR policies for 249 Central Public Sector Enterprises (CPSEs). The transition from voluntary to mandatory CSR activities was proving difficult for many. As a result, an effective framework was required to ensure the success of 'mandatory' CSR initiatives, which was proposed to the DPE for effective management of CSR activities in all those CPSEs. In the mandatory CSR, the government becomes directly related to the social, economic and environmental dimension of the corporate entity and becomes answerable for all kinds of actions of businesses. As a watchdog, the government tries to ensure over-all welfare, peace, equality and security to all concerned. Businesses act as efficient partners, address challenges and hence business activities include societal impacts.[26]

When government acts in two capacities, namely, watchdog and partnership, four roles can be identified for the government which will help in sustaining CSR initiatives. These are mandating, facilitating, partnering, endorsing and enforcing roles.[27]

[25] Sharma (2005).

[26] Ministry of Heavy Industries & Public Enterprises, Government of India, Department of Public Enterprises. New Delhi (March 2010). *Guidelines on Corporate Social Responsibility for Central Public Sector Enterprises.* 15(3)/2007-OPE (GM).

[27] Atale and Helge. (2016). Retrieved from http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.904.8159&rep=rep1&type=pdf.

Mandating: In the 'mandating' role, a minimum standard which business must act upon within their legal framework. DPE has to define minimum standards for CSR performance, which need to be embedded within the legal framework. The mandatory role is accompanied by the policy guidelines with regards to the CSR thrust areas. DPE has to align its mandating norm as well as thrust areas, to meet the needs of the time and also with the changing business climate. The diverse nature of CPSEs and their geographical spread in culturally diverse areas are some of the key issues in ensuring 'mandating' success.

Facilitating: In their 'facilitating' role, the DPE should encourage and provide tangible incentives as well as necessary support to companies to push CSR tasks and thus, help address social and environmental issues. It could also be extended to other functions such as purchasing, including facilitating 'green' purchases. To encourage smoother relations among CPSE–state government and local government can also be included as another aspect of facilitating, which is crucial in ensuring the smooth implementation of CSR initiatives.

Partnering: Collaborative partnering through partnerships among society, public and private sector to tackle difficult social and environmental problems can be covered under the role of partnering by the government.

Endorsing: Endorsement is direct recognition of best practices followed by a particular CPSE and ultimately rewarding such initiatives motivates others to follow by example. DPE should work with other central government bodies and over the period amend/modify its best practices so as to stay at the forefront of policymaking. At present, the government including the DPE are not endorsing any of the CSR activities of CPSEs.[28]

Enforcing: To ensure accountability the fifth potential government role is enforcing. The success of mandatory CSR lies in effective enforcement. It may be done by any of the ways for e.g. by sending notifications through DPE and keeping senior management accountable for CSR activities in their respective organizations, establishing a central watchdog, imposing a stiff penalty or even by nominating one independent director etc. to ensure the progress and successful implementation of CSR initiatives.

Therefore, in the present decade, with the governmental intervention, CSR in India has started focussing on practically, all the stakeholders including government, customers, employees, community and media. The Companies Act, 2013 is landmark legislation that made India the first country to mandate and quantify CSR expenditure. The inclusion of CSR in the Act is an attempt by the government to engage the businesses with the national development agenda. GOI has made it mandatory for all public sector enterprises to spend a certain percentage of profit after tax (PAT) for CSR. In Companies Act, 2013, Section 135 provides for need-based CSR activities to be implemented by the companies (public as well as private) and constitution of

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[28]The World Bank (2002) also highlighted one of the important roles as 'endorsing'. It has been perceived that this plays an imperative part in getting political support in CSR exercises. Consciousness about complexities of social and cultural elements across the spectrum plays a significant function in recognizing; investigating, actualizing, screening and assessing issues identified with the CSR activities.

broad level CSR Committees, which are responsible for recommending, monitoring CSR policy and its implementation plan.[29] The Act came into force from April 1, 2014, every company, private limited or public limited, which either has a net worth of Rs 500 crore or a turnover of Rs 1,000 crore or net profit of Rs 5 crore, needs to spend at least 2% of its average net profit for the immediately preceding three financial years on CSR activities. An average of last three financial years PAT will be considered for calculating 2% of CSR, which is not mandatory, but the Companies Act, 2013 casts an obligation on the Board to specify reasons for not spending the specified amount on CSR. The CSR activities in India should not be undertaken in the normal course of business and must be with respect to any of the activities mentioned in Schedule VII of the Act.[30] The corporations are required to set up a CSR committee which designs a CSR policy which is approved by the Board and encompasses the CSR activities the corporations is willing to undertake. The Act also provided for the CSR committee on the Board will comprise of 3 or more Directors out of which, at least one Director should be an independent Director. Penal provisions for corporations and individuals for failure to abide by the norms have

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[29]The Companies Act, 2014, Section 135: Corporate Social Responsibility—

(1) Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

(2) The Board's report under Section (3) of Section 134 shall disclose the composition of the Corporate Social Responsibility Committee.

(3) The Corporate Social Responsibility Committee shall,—

(a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;

(b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and

(c) monitor the Corporate Social Responsibility(CSR) Policy of the company from time to time.

(4) The Board of every company referred to in Section (1) shall,—

(a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility(CSR) Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and

(b) ensure that the activities as are included in the Corporate Social Responsibility Policy of the company are undertaken by the company.

(5) The Board of every company referred to in Section (1), shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy:

Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities:

Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (o) of Section (3) of Section 134, specify the reasons for not spending the amount. Retrieved from http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf.

[30]SCHEDULE VII: In exercise of the powers conferred by Section (l) of Section 467 of the Companies Act, 2013 (18 of 2013), the Central Government hereby makes the following amendments to Schedule Vll of the said Act, namely:- (l) In Schedule Val, for items (i) to (x) and the entries relating thereto, the following items and entries shall be substituted, namely:-

also been provided under the Act.[31] National Financial Reporting Authority has also been constituted under the Act[32] for recommending the Central Government accounting and auditing policies and standards for adoption by the companies along with monitoring and ensuring compliance by them, but have not linked it directly with CSR activities of the companies.

Despite all these regulatory and legislative measures adopted by GOI, the value of CSR activities and their areas of implementation are not very encouraging, if analysed from the surveys and researches undertaken at different times. After 2000 onwards, many surveys have been conducted and macro level analysis about Indian corporate regarding CSR activities have been discussed hereunder briefly:

Business Community Foundation TERI Europe conducted surveys in 2000 and 2001, which found that for CSR activities, many companies were collaborating with NGOs and working mainly for labour and environment benefits. A joint **Survey conducted in 2002 by CII, United Nations Development Program (UNDP), British Council (BC) and Price Water Coopers (PWC)** concluded that mere passive philanthropy is done, which is not sufficient and recognized CSR as a means to enhance long-term stakeholder value.[33] A more detailed **Karmyog**

"(i) eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water;

(ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

(iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for the promotion of sanitation;

(v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

(vi) measures for the benefit of armed forces veterans, war widows and their dependents;

(vii) training to promote rural sports, nationally recognised sports, Paralympic sports and Olympic sports;

(viii) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

(ix) contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;

(x) rural development projects;

(xi) slum area development.

Retrieved from http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf.

[31] The Companies Act, 2013, Section 136.

[32] The Companies Act, 2013, Section 132.

[33] Current Trends in CSR Practices: Issues & Challenges in its Implementation & Regulation (2002). Retrieved from http://shodhganga.inflibnet.ac.in/bitstream/10603/35689/14/14_chapter%205.pdf.

Table 10.1 Summary of CSR rating of top 500 companies

Karmayog CSR rating	No. of companies	Companies with given rating (%)
0/5	231	46
1/5	92	18
2/5	138	28
3/5	35	7
4/5	4[a]	1
5/5	0	0
Total	500	100

[a]HDFC, Infosys, Tata Steel, Titan Industries

Research Survey of 2007–2008 analysed current scenario of CSR activities in 500 largest Indian companies, which were rated on 0 to 5 scale based on criteria like products and services, CSR reaches and extent, environmentally harmful/safe processes etc. Startling revelations came forth—out of 500 companies, 231 got 0 rankings for showing no CSR activity and thus filtered out. Remaining 269 companies depicted varying degrees of commitment towards CSR initiatives and implementation. Majority of companies either do not have any clear strategy and spending on CSR activities and make only token gestures by employing ad hoc methods or merely by utilising it as a marketing tool to spread their business, which is many times unconnected with the business process itself. Many give donations or charity to some charitable trusts, NGOs or for sponsorship of events etc. believing that it is equal to CSR. Very few, only countable number of companies showed their clear CSR policies and activities in tune with governmental initiatives along with proper reporting and disclosures in their balance sheets or annual reports. Detailed analysis of the Survey can be seen in the following chart (Table 10.1).

From the above analysis and surveys conducted, CSR in India during the last decade seems to be in the budding stage, the scope and extent of which has got confused and has not gone beyond charity or voluntarism. By governmental policies and legislative initiation, it has been made obligatory upon companies, essential for their own financial performance and benefit, much more than mere reputation or goodwill enhancement. In a way, standardization of CSR for all companies has come a long way, which has become difficult for the business to ignore. Apart from that CSR reporting and standardized disclosures, which is recognised practice globally and if Indian companies have to grow and compete with other companies world over, they will compulsorily have to abide by all these international standards already laid down and being followed.[34]

Many governments have attempted worldwide to encourage CSR initiatives and reporting by incentivization or by regulation. In 2007, the Malaysian government passed a regulation to mandate all public companies to publish their CSR activities

[34]Ibid.

in their annual reports on a ‘comply or explain’ basis.[35] Denmark in 2009 made it mandatory to report their social initiatives by all state-owned companies on other companies on the basis of their total asset or revenue value or a number of employees. In Britain also, in 2006 British Companies Act provided that information regarding CSR activities of all the companies listed in the UK is compulsory to be included in their annual reports which will include both mandatory and voluntary standards.[36] Many countries have linked CSR activities and their reporting in guidelines released through their country’s stock exchanges, for e.g. companies in China prefer their CSR reporting through the Shanghai and Shenzhen stock exchanges. Similarly, all companies listed on French stock exchanges have been mandated to report on the environment, social and governance front by a law called ‘Grenelle II’.[37]

10.4 CSR: Current Trends in India

CSR movement recognizes that corporations are important and powerful players in today’s world.[38] If these corporations start actively participating in the development agenda and take full account of peoples’ expectations, societal and environmental goals can be achieved expeditiously. Real business investment and involvement, if extended beyond the production of goods and services may lead to successful social and economic regeneration crucial for reversing the deeply rooted problems of deprivation and misery. The development impact of the CSR activities and strategies can be multiplied if human rights perspective and good governance could be integrated into it. It involves improving bureaucratic and political accountability, fighting corruption, promoting people’s participation and making effective and efficient use of the nation’s resources.[39]

Corporate Social Responsibility (CSR) is now an integral part of most Indian businesses, after the incorporation of Section 135 in the Companies Act. India’s top 100 companies have CSR policies in place and make full disclosures of their CSR initiatives in annual reports. KPMG’s yearly ‘India CSR Reporting Survey’

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[35]The Hauser Center for Non-Profit Organisations at Harvard University.Current Corporate Social Responsibility Disclosure Efforts by National Governments and Stock Exchanges. Retrieved from http://hausercenter.org/iri/wp-content/uploads/2011/08/CSR-Disclosures-Update-6-27-13.pdf.

[36]Chamber (2013). 11 Retrieved from http://www.ey.com/Publication/vwLUAssets/EY-Government-and-Public-Sector-Corporate-Social-Responsibility-in-India/File/EY-Corporate-Social-Responsibility-in-India.pdf.

[37]Ibid.

[38]460 companies spent Rs 6,337 crore for CSR in FY’15: FM Arun Jaitley (March 01, 2016). *Press Trust of India.* Retrieved from http://economictimes.indiatimes.com/news/company/corporate-trends/460-companies-spent-rs-6337-crore-for-csr-in-fy15-fm-arun-jaitley/articleshow/51208051.cms.

[39]Ramachandran (2017). Retrieved from SSRN: https://ssrn.com/abstract=3059833 or http://dx.doi.org/10.2139/ssrn.3059833.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3059833.

that analysed India Inc's CSR activities until September 30, 2017, reveals that the instances of companies spending less than two per cent of their profits have decreased in the past three years.[40] More structured CSR budgets have been put in place now and many organisations are seeking the support of 'external implementing agencies.' Here are some key CSR trends that emerged in 2017:

- Maharashtra, Uttar Pradesh, Tamil Nadu, Karnataka and Odisha are the top five states which have implemented the maximum number of CSR projects. These account for 32% (or 629 projects) of all CSR projects and initiatives underway in India. Maharashtra has topped the list for three years in succession.
- India's seven north-eastern states received some CSR traction during the year with over 70 CSR projects being executed in those regions, which is a 51% rise in the number of projects since 2014–15.
- Maharashtra, Haryana and Gujarat lead in terms of CSR funding received. The average project cost in Haryana is the highest at Rs 8.4 crore, followed by Andhra Pradesh (Rs 6 crore) and Gujarat (Rs 3.6 crore).
- In 2017, sectors of education and healthcare accounted for over 56% (Rs 4,045 crore) of the total CSR spends (Rs 7,215.9 crore) in India. Both these sectors have traditionally been in focus. Expenditure towards education has grown a massive 92% over the last three years (from Rs 1,249 crore to Rs 2,404 crore), part of it may be due to the government's push for the girl child's education through its 'Beti Padhao Beti Bachao' drive.
- Companies ensuring diversity in representation, which had higher women as members in their committees/boards had more programmes dedicated to reducing gender inequality. Out of 116 CSR activities undertaken to reduce inequality, 67% of them were implemented by companies with women in their CSR committees.
- Telecom sector, despite being burdened with high debts, has increased its CSR spends by nearly 400% since 2014–15. Pharma followed, with a 234% rise in CSR expenditure.
- According to the Ministry of Rural Development, India has a total of 640 districts, of which 43% (272) are regarded as 'backward districts.' Despite this, only 15% of CSR budgets were allocated to activities in these districts in 2017. In Bihar, which has the highest number of backward districts (38), only 14% of the CSR expenditure was concentrated in these areas.
- Public sector companies executed 22% (421) of all CSR projects in 2017 accounting for 31% of the total CSR expenditure. Non-PSUs, on the other hand, implemented 78% (1,474) of the projects. The average project cost, however, was higher for PSUs at Rs 5.1 crore than non-PSUs at Rs 3.2 crore.
- Only 5% of all CSR projects in 2017 was executed by companies of non-Indian origin. These accounted for a mere 3% of overall CSR expenditure. The average project cost of non-Indian origin companies' was Rs 2.1 crore which was lower

[40] KPMG (2018): India's CSR Reporting Survey. Retrieved from https://assets.kpmg/content/dam/kpmg/in/pdf/2018/02/CSR-Survey-Report.pdf.

than the expenditure of Indian companies', the average project cost of which was Rs 3.7 crore.[41]

In 2017, KPMG evaluated N100 companies and the following documents were captured from the public domain and published as 'India's CSR Reporting Survey 2017:

- **Availability of CSR Policy in Public Domain:**
- **95 (2014–15); 97(2015–16); 98(2016–17)**

CSR disclosure in the prescribed format was made by 98 companies in 2017. 2 companies do not have CSR policy in the public domain, and have failed to make this available in the public domain for the third year in a row.

- **Availability of Vision/Mission/Philosophy of CSR Policy:**
- **90 (2014–15); 95(2015–16); 94(2016–17)**

Disclosing details regarding CSR vision/mission/philosophy is not a mandatory requirement as per the Act. Still, 94 companies have disclosed these initiatives, which is a good practice.

- **Disclosure on the Area of Intervention in CSR Policy:**
- **92 (2014–15); 96(2015–16); 97(2016–17)**

Disclosing details regarding CSR areas of intervention has been mandated in the Act. Total 97 companies have disclosed details regarding CSR intervention area in their CSR policy. Many more companies indicate very specifically their areas of interventions compared to stating that they will be covering aspects as per Schedule VII, which is an indication of a clear strategic direction in CSR compliance.

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[41]Mitter (2018). Retrieved from https://yourstory.com/2018/03/9-emerging-trends-from-india-incs-csr-activities-in-2017/.

- **Disclosure on the Monitoring Framework in CSR Policy:**
- **90 (2014–15); 89(2015–16); 92(2016–17)**

Disclosing details regarding the approach towards monitoring of CSR interventions is a mandatory requirement under the Act. 92 companies have disclosed details regarding a monitoring framework.

- **Disclosure on the Mode of Implementation of CSR Policy:**
- **88 (2014–15); 91(2015–16); 92(2016–17)**

Disclosing details regarding mode of implementation is a mandatory requirement of the Act. 92 companies have disclosed their mode of implementation in the CSR policy in 2017.

- **Availability of Governance Structure in CSR Policy:**
- **75 (2014–15); 87(2015–16); 92(2016–17)**

Companies include governance details and responsibilities of CSR committee members in their CSR policy. Disclosing details regarding CSR governance structure is not a mandatory requirement of the Act. But, a majority of the companies (92) have disclosed details regarding the CSR governance structure, as compared to 75 in 2014–15) shows a substantial increase indicating progress towards growing transparency and accountability.

- **Disclosure on Treatment of Surplus arising from CSR Projects:**
- **63 (20104–15); 71(2015–16); 69(2016–17)**

The Act mandatorily requires that surplus arising out of the CSR projects or programmes or activities will not form part of the business profit of a company. Over 30% of the companies still do not disclose details regarding the treatment of surplus arising from CSR projects, which is a concern.

It can be seen that the practice of CSR in India has moved from community development to institutional building (educational, research and cultural) through various projects which hitherto was merely in the philanthropic space. With global influences and with communities becoming more active and demanding, there appears to be a discernible trend, that CSR is getting more strategic in nature and getting linked to business than philanthropy. A large number of companies are now reporting the activities undertaken in their official websites, annual reports, sustainability reports and even publishing CSR reports. The Companies Act, 2013 has introduced the idea of CSR to the forefront and through its disclose-or-explain mandate, is promoting greater transparency and disclosure. By integrating CSR into its core operations of the companies, it has reached beyond the communities and beyond the concept of philanthropy.

10.5 CSR, the Indian Constitution and the Government

Business and society are interdependent. Separation of these two is not only impractical but should also not be done as these complements each other. The business develops and flourishes due to increasing demands of goods and services from the society and therefore, the business also must take care of each and every element of society to get continuous support for its growth and sustenance. The interdependence of business and society is inseparable and it is the only peaceful co-existence of capital and labour which ensures and sustains the development of both. To strike proper balance between the two, Indian Constitution has provided for several provisions under its Parts III, IV and IV-A,[42] Fundamental Rights, Directive Principles of State Policy and Fundamental Duties respectively. Under Article 19(1)(g), the State has guaranteed all individuals the fundamental right to practise any profession, or to carry on any occupation, trade or business, which can be restricted on the ground of 'interests of the general public.' This conditional right may only be regulated or restricted within the limited sphere, and the imposition of mandatory and obligatory CSR comes under this constitutional imperative. Moreover, it is in the furtherance of the Constitutional mandate provided under Article 38, wherein State is to strive to promote the welfare of the people by securing and protecting a social order based upon social, economic and political justice.[43] It is for the State to ensure that there are minimum inequalities in income, status, facilities and opportunities,[44] State policies provide for securing equal and adequate means to livelihood, appropriate distribution of communities' resources for the common good, with no concentration of wealth or economic exploitation or moral and material abandonment.[45] There are also provisions for the right to work, education, public assistance in cases of sickness, disablement or of undeserved want along with the provisions for just and humane conditions of work and maternity benefits.[46] The State shall also endeavour to secure living wages, decent standard of life and work and to secure the participation of workers in the management of undertakings, establishments etc.

Despite the clear Constitutional mandate and the legislative requirement, from the above-stated surveys, few companies seem to have started contributing towards CSR, thinking and perceiving as their fundamental obligation. As per the imposition, they may be performing their part to the extent mentioned, but the question of proportionality remains unanswered. The loss caused to the health and strength of

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[42]The Constitution of India, Part-IV-A, pertaining to Fundamental Duties was added *vide* Constitution (Forty-second Amendment) Act, 1976, which provided for various duties of every citizen of India, viz. 'to abide by the Constitution and respect its ideals and institutions'; 'to protect and improve the natural environment, to strive towards excellence in all spheres of individual and collective activity so that the nation constantly rises to higher levels of endeavour and achievement' etc.

[43]The Constitution of India, Article 38.

[44]Ibid.

[45]Ibid. Article 39.

[46]Ibid. Articles 41 & 42.

workers, their social and economic exploitation, along with the worrying scales of environmental degradations caused due to the apathy of the traders, manufacturers or the businessmen compels everyone to think, whether mere imposition to a certain extent or sharing of part of profit absolve them of their community responsibility or something more than that is the need of the hour. Government has to think for more stringent measures such as introducing a compulsory insurance cover for every worker/employee by the employer, creation of a statutory fund for providing relief to the worker or his family in case of accident, death, compulsory provisions for crèche and educational facilities for their wards etc. Unless they are unable to feel that compassion and an obligation for the workers and their families, simply sharing of profit would not suffice the Constitutional imperative.

10.6 Conclusion

The legal impositions and regulations by the governments at every level of CSR initiatives, implementation and reporting or disclosures as discussed above have become the norm of the modern corporate world. Essentiality of CSR activities has abetted the governments to act and scrutinise the corporate at every step, as their working affects all facets of human life and its surroundings. With the increased governmental and public expectations, some positive swing towards direct engagement and contribution of business in the mainstream socio-economic development and environmental protection can be witnessed. In India, due to the existing wide gap between sections of society, in terms of their socio-economic status, the role of government and its insistence and assurance for effective and perceivable CSR becomes more pertinent in the light of Constitutional commitments. As our Constitution guarantees to each one of us a meaningful life with justice, equality, liberty and dignity, this is for the government to innovate ways and means to ensure their fulfilment and for which one of the plausible and appropriate ways is to rope in corporate in this endeavour, as they hold the majority of resources, only requirement is to strategise and enforce the will and commitment effectively, so that pieces of cake can more evenly be distributed. As rightly said by Alice Korngold—

> Global corporations have the human capital, the financial resources, the technology, the international footprint, the power of markets and the profit motivation to build a better world. NGOs will be essential partners…Governments will be essential partners…By engaging together through an iterative process, we will achieve "A Better World."[47]

[47]Korngold (2014). *A Better World, Inc.: How Companies Profit by Solving Global Problems…Where Governments Cannot.* Palgrave Macmillan Publisher.

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Chapter 11
The Sreni-Drawing the Legacy of CSR in India

Anjana Hazarika

Abstract The paper "The Sreni-Drawing the Legacy of CSR in India" traces the origin of Corporate Social Responsibility (CSR) in India. It examines corporate forms that existed in Ancient India. Though there were number of entities involved in trade and craftmanship during that period but the Srenis remained the most predominant of all. This study examines the factors behind the establishment of Sreni as an economic, political, financial and legal entity. The Sreni could master over all these spheres because of its governance system. The internal governance mechanism made the Sreni consistent in its organizational system. A centralized management system, induction methods for new members, apprenticeship process for learning new crafts formed the basis of its prominence in the society. Such aspects of Sreni were crafted in such a manner that despite existence of other systems, it remained as the most significant entity. The Sreni with its centralized management also created space for democratic functioning. The backbone to all these lies in the Sreni dharma. Public trust and faith cannot be dissociated from the Srenis. Successful performance of their task, maintaining internal coherence, fairness, honest dealing and faithful discharge of their responsibilities and obligation had helped them to have trust over the public. Hence trust and faith of the public added value to Sreni CSR.

Keywords Sreni · Sreni dharma · Governance · CSR · Public trust · Centralized management system

CSR has been observed as a philanthropic activity, and it was in keeping with the tradition for which India was known for. Though these activities were carried out with serious deliberations but were voluntarily adopted as a part of its core activities. Gradually, it became more and more drawn towards social development (Sarkar

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and Sarkar 2015). As time passed by CSR came under the preview of both policy makers as well as corporation's stakeholders due to the prominence of governance issues. Currently CSR achieved a mandated status, but remarkably its origin lays with corporate activity in Ancient India.

11.1 Business as a Corporate Activity in Ancient India: The Rationale of Business as a Corporate Activity

In Ancient India, business was conducted as a corporate activity like any other activity and not as individual initiative. It was not due to any choice or interest rather the rationale was that it was the security and safety concerns of participants which were more important.

For they knew that if they remain united, they had lot of advantages and can stand up against any odds and gradually with growing trade activities, incentives for collective efforts also grew and forced people to travel and sell their produce (Thaplyal 1996, p. 12). Travelling was not an easy exercise, especially when one has to move with their produce through foreign territories and had to deal with various challenges that could evolve from such exchanges. In order to deal with such challenges, it was prescribed to form joint initiative or compact, which would help them to perform their activities. So collective effort driven by social instinct became the support system of day to day business activities at that time.

11.2 Co-operation Became the Backbone of Other Spheres and not just Trade

It has been observed that trade activities were not merely driven towards economic achievement and guided by its own rules and procedures; rather it is driven by social instinct. These activities became prominent according to the whims and fancies of mankind, and circumstances in which these activities survived. These circumstances dictate the form of organization, but its nature of development depends to a large extent upon the type of society in which it is fostered and nurtured. The co-operate origin of the business activity boosted the growth of economic exchange (Khanna 2006). This was not just true of one society, rather in all ages and in almost all countries across different fields of human activity, it was the baseline. Co-operative activity is just not the core of commercial activities; it is also the backbone of social, political, religious sphere with its marked manifestation in economic sphere. Organizations which carried out activities in multiple spheres had to condition accordingly, and these organizations catered to the demands of the societal need by assuming multiple roles.

11.3 Diversity in Co-operation and the Primacy of Sreni

Corporate organizations existed in myriad forms in Ancient India. These organizations existed in the form of family-run business and individual run business. But that was not all Ancient India witnessed other form of business activities by different organizations with gana, puga, vrata, samgha, nigama and Sreni. In fact, Sreni, nigama, gana, puga, vrata and samgha were used in ancient Indian texts to denote corporate organizations. However, opinion varies regarding the scope and meaning of these terms.

In this paper, Sreni or the guild will be the focus of discussion, primarily to understand the legacy of governance and corporate social responsibility in Ancient India.

It is remarkable that it was not just the Sreni, but other entities like gana, samgha, and nigama had significant bearings in other aspects of the society (Majumdar 1969). These entities had significant influence in other aspects of the society, and contributed to the trade and business activities. Therefore, Sreni was just one of those units.

11.4 Srenis—Origin and Allegiance to Multiple Activities

Popular as guild, and locally known as Sreni, and more known as facilitator of production and exchange, the proximity of the Sreni and the guild didn't remain uncontested. Prominent Historian, Romila Thapar (2002) argued that Indian guilds or Srenis were not same like the Medieval guilds of Europe, but others differ and found Srenis corresponding to guilds in Medieval Europe (Majumdar, p. 15) except its local variance. They were similar on few counts, but its detailed rules of internal organization made them distinct from the medieval guilds of Europe. Besides, there were other corporate bodies like nigama which were not very distinct and full of ambiguities regarding their functions. It is sometimes rendered as paurasamurah or just a body of citizens (Sharma 1986). These bodies do not accept the authoritative appeal of the scriptures not even the Vedas, and do not enjoy universal connotations (Kane 1991). Nigara and nigama, had territorial connotations as they were two types of township, nigara being the ordinary township and nigama being the market one (Khanna 2006). Being a market township, predominant activities of nigama were trade and business activities, but it could not develop a strong hold over the society like the Sreni. These entities were maybe similar on few counts, but varied on several aspects (Khanna, p. 8). But it is true that these entities kept the corporate life alive in ancient India, and the most prominent being the Sreni.

Sreni with its complex character was prevalent with its allegiance to not just one single profession but to multiple professions and crafts. That is why the members of each Sreni were free to align with other corporate bodies to nurture their varied skills of craftsmanship (Majumdar 1960). Multiple allegiances of Sreni members with different organizations pointed towards a liberal outlook and appreciation of ownership of different skills and craftsmanship. It was apparent when members of silk weaving Sreni practiced archery or astrology (Thaplyal 1996) along with their original activity. Hence, freedom of choice persisted regarding the practice of one's skill without any interference from any authoritative body. Also, prevalence of Sreni in the ancient Indian society pointed towards an active culture of business and trade activities during that period. This paved the ground for occupational specialization, which itself was indicative of a developed economy. Sreni's and its mobile nature proved beneficial for its trade and craft activities, without any threat from outside forces (Thapar 1998).

11.5 Sreni Governance and Corporate Social Responsibility in Ancient India

Srenis were not mere corporate entities who were into regular trade and business activities but were involved in different spheres of the society and indulged in multiple activities. This was believed to be possible due to its own internal governance mechanism. Also, several factors provided the ground for the Sreni to establish itself as a strong entity, without any strong contenders. A centralized management system, induction methods for new members, apprenticeship process for learning new crafts formed the basis of its prominence in the society. Such aspects of Sreni were crafted in such a manner that despite existence of other systems, it remained as the most responsible entity.

The Sreni had the capacity to deal with diverse spheres of the society. The key to its indulgence lies in its governance structure. The governance structure of the Sreni, which became the core of its functioning didn't happen in few years, it developed over a period of time especially when it assumed multiple responsible tasks. Also, predominance of the Sreni in Ancient India was not only because of their pure business sense, but also for their governance skill. The apt governance system established within the Sreni helped them to strengthen their multiple skills. The Sreni utilized its governance skill both in business, civic and other administrative affairs.

It is very interesting to note that the governance skill of the Sreni surpassed other corporate bodies and this paved the way towards the extinction of these entities. That was not all, Srenis were not just confined to economic activities, but were actively involved in state activities. In fact, the Sreni came to the aid of the state in terms of state consolidation and collection of revenue (Mitra 2007). Therefore, the Sreni was involved in the overall development of the state, and this had a huge impact on the community. Common people were swayed by the Sreni system of governance. Therefore, the loyalty of the common people shifted from tribal organizations to Srenis which had politico-geographical control. Behind its establishment as a significant economic, political, social, financial and legal unit, one needs to examine other developments namely, the two dynastic period of Mauryas and the Guptas, the sixteen mahajanapadas (Raychaudhuri 1953) introduction of writing, coinage (Sircar 1968), religious teaching of Buddha and Mahavira and the highly sophisticated pottery the Northern Black Polished Ware (Thaplayal, p. 24), and a huge use of iron, which brought about a shift of loyalty of the citizens from tribal organizations to strategic, political and economic units like Sreni (Ghosh 1973).

11.6 Factors Behind the Prevalence of the Sreni

The Sreni owes its prevalence in the society to primarily two dynastic rules, the Mauryas and the Guptas. The Mauryas known for well-knit administrative system, were also keen admirers of art, literature, and science. But their interest in different forms of art didn't deter them to support trade and commercial activities. Trade and commercial activities were highly supported and regulated by the state (Thaplyal 1972, p. 23). Besides, the Mauryan rulers were more into state consolidation and expansion, hence revenue collection was very essential for the empire. But handling such multiple activities was becoming a challenge to the monarchy. Srenis were given the responsibility to deal such matters. Hence, they didn't remain as just mere economic organizations but shared political roles with the state, and sometimes alone.

Sreni's have assumed these responsibilities not only because of their dexterity in work or their command over administration, but it is the support from the state as an institution, and the blessings of the royals that made them leaders of administration. With the developments of sixteen mahajanapadas, introduction of writing, coinage, teachings of Buddha and Mahavira and the highly sophisticated pottery, the Northern Black Polished Ware, and a huge use of iron, brought about a shift of loyalty of the citizens from tribal organizations to Sreni. With such forces at the backdrop, every craft was organized into Sreni, and a huge specialization phase took off. Earlier crafts like gold-making, silver-making, which were single person's craftmanship turned into specialized form of corporate activity. Gradually, the Srenis gained monopoly and discretion over business, and the state also recognized the significance of their role in economy and society but didn't give a free hand in their activities and applied some sort of controlling mechanism. Hence, the office of the Bhandagarika was created by the state so that Srenis does not become monopolistic.

11.7 Role of Monarchy and Sreni Governance

In Ancient India, the Mauryas and the Guptas the two powerful dynasties of that time took a lead not only in regular administration of the state but understood the importance of trade and business. The Gupta period though paid extreme importance to art, literature and science, but held trade and commerce as equally important and such trade was not just restricted to domestic mode only. It indeed had an international mode of trade transaction which was more or less official.

It is remarkable to note here that trade was not just for essential commodities, but international trade was carried out with valuable and luxury items (Fick 1920). The reason behind such priority to trade was the huge revenue and external relations it drew from such activities. This was quite extraordinary keeping in mind the challenges that the businessmen and the craftsmen encountered at that time.

The Mauryan rule came out with wholehearted support for trade and commercial activities, and the Sreni's benefitted a lot. But these commercial activities were not just conducted alone rather it was supported by a uniform and efficient system of administration. The state also didn't give a free hand to these institutions. It recognized the importance of such institutions and their activities but retained some control over it by imposing taxes in cash or kind, and at the same time providing some concessions (Rangarajan 1992).

Gradually, business became crucial to the economy and the state also understood the significance of it, so exclusive zones were created within the towns for running businesses with least interference from the state. Provisions were made by the state for the Sreni's to deposits required amount with reliable and competent agencies, and at times of crisis and advanced loans to the merchants. But the state retained the monopoly of collecting the revenue from the Sreni. It was a sort of controlled freedom established by the state on trade and business activities so that it benefits both the state and the Sreni. The importance of state monopoly was not just preferred by the royalty, but prominent scholars like Kautilya vehemently supported it. Though a strong supporter of trade, he feared division of allegiance of the subject take the form of state within the state which will prove detrimental to the state itself (Thaplyal 1972, p. 28). Hence, with such checks, Sreni were kept under control, but their role in bolstering the economy couldn't be stopped. Rather, one should say it was trust and responsibility in their craft that forced the Mauryan rulers to rely on them. The business skills of the Srenis were far ahead of time and this skill helped them to assume other roles effectively. During the Mauryan period the state tried to control the Srenis but their contribution to the economic growth of the society stopped the state from assuming such a role. Even with the breakup and weakening of the state, the Srenis never lost their command over the trade and the community. Rather with the breakup and weakening of the state, the Sreni gained more power and freedom and this was primarily because of their governance skill.

11.8 Internal Governance System of the Sreni

Business dexterity and skill which the Sreni gathered over the period was because of its detailed internal governance system. The detailed governance system was fully functional to keep the members of the Sreni bonded, and the customs, traditions of the Sreni were strong enough to form the force of law. Besides, Sreni services were utilized for no single occupation rather it was used by various occupations.

11.9 The Three –Tier System of Sreni-Governance

The systematic functions of the Sreni system contributed to the consistency in Sreni governance. This consistency was possible due to the well devised role assigned to its members, and its three-tier system of governance. The three-tier body comprises of the General Assembly, Executive Officers, and the Head of the Sreni.

The body of General Assembly being the most important component consists of members with no higher limit of membership. In the absence of any system and infrastructure, the General Assembly, Office of the Headmanship and the body of Executive Officers provided the base for building up business acumenship, financial, legal and administrative skill at the state and local level. In fact, the key behind the successful maintenance of these functions was mutual confidence. Mutual confidence was believed to be the key element in the smooth functioning of the Sreni, keeping in mind its huge membership. The membership process was carried out through three rigorous induction methods especially to the highest chamber, the General Assembly. Moreover, these were essential for its management.

11.10 Centralized System of Management—a Crucial Factor in Sreni Governance

In normal administration, it was difficult to administer in groups with such a huge contingent, and so smaller group were formed and given responsibility for day to day operations and management. No strict rule was laid out regarding the numerical strength of the Sreni, rather it was kept open, and no eligibility criteria was fixed for membership. The reason behind the effective functioning was the centralized system of management. The centralized system of management is headed by the headman whom the Sreni connoted as jetthaka, or pamukkha (Majumdar, pp. 46–47), but it is a different matter that opinions differed regarding the universality of the designations across all Srenis. There was no doubt that skill, intelligence and wealth are few pursuits that the headman should own (Mookerji 1919, p. 47). While others indicate that the office of the headman may be honorary or paid one or held it for a time period or lifelong (Basham 1954), but its strong role in the management of the Sreni cannot be denied. He could bind the members in contract and control, and overall administrative authority within the Sreni (Dandekar 1982, pp. 38–39). The headman was required to address lot many matters and he had to run the Sreni with the assistance of two or more executive officers who had the power to bind Sreni together (Brihaspatismriti cited in Thaplyal, p. 51). The most important qualification for the executive officers was to be well versed with the Vedas (Majumdar, p. 56).

With a centralized system of management in place, the authoritative nature of the headmanship was upheld for the benefit of the Sreni. But if the headman tried to monopolize the office for some matter not entirely beneficial for the Sreni, then strict actions awaited against the Sreni Head. If the assembly finds fault in his leadership or any other matter which is detrimental to the Sreni and its members, he can be sacked from office without any doubt. And then the state also ensures that the next leadership in the line would not go to anyone in relations with the corrupted headman nor chosen or designated by him. With the huge amount of work load he had to shoulder; the headman was assisted by the executive officers of the Sreni. Like the office of the headmanship, their appointment as executive officers were based on their command over Vedic knowledge or sometimes nobility of their family status (Majumdar, p. 58) and of course, proficiency in their craft. These executive officers exercised considerable authority over other members of the Sreni, in their official capacity. This in turn strengthened the centralized system only.

11.11 Transgressions and Sreni Functioning

Being a business unit, rules and agreements formed the core of its functioning. Transgressions of such rules and agreements were highly abhorred. Still, if an errant member of the Sreni transgressed the agreement or falls out with his associates, under such circumstances the executive officers can confiscate the errant member's property, or in extreme cases can be banished from the land. This clearly indicated gravity of the act, its impact on the Sreni functioning, and also the strength of the governance system.

In spite of the centralized management system, where the headman and the executive officers held considerable authority, there were room for other members to bind the Sreni, provided they were authorized to do so. If any Sreni member without any authorization of the Sreni causes loss to the Sreni, then the member has to compensate the other members

11.12 Sreni Dharma and Democratic Functioning—the Cardinal Principle of Sreni Governance

The core to the Sreni dexterity and acumenship lies in its governance skills. The way the Sreni has developed its multifarious roles, the reason lies in the management of the three- tier system of the Sreni. The Sreni with its centralized management also created space for democratic functioning. The backbone to all these lies in the Sreni dharma. Sreni dharma acts as a guiding principle for various aspects of the Sreni, ranging from election, removal of the headman officers and other members, production practices, prices, quality control etc. (Thaplyal 1972, p. 72).

The Sreni dharma was the essence behind the functioning of the Sreni. Sreni owes its stability, order and growth to Sreni dharma. Every aspect of the Sreni is based on it, and it is an end product of discussions and deliberations. It is also argued that the democratic aspects of Sreni governance owe its inspiration from the dharma. The dharma preaches and advocates democratic expressions in everyday functioning. It applied to all members of the Sreni. No distinctions were drawn in terms of the application of the Sreni dharma.

The application of democratic principles is not just that overviews transgression of Sreni principles, but it also covers member's objection against certain penalties. If any member felt that the penalty imposed was unjust then the member could appeal to the king. And if the king found the penalty to be motivated by ill will and outside the Sreni dharma, then the king acquits the indicted offender without any hesitation. The headman and the officers had considerable power within the Sreni, but it is also true that their autocratic or unruly behavior doesn't go unchecked by the royalty. If such a matter is reported to the king, there is a high probability that all his property may be confiscated or even vanished from the community.

Establishing a Sreni was just the beginning, but its real work starts with building up the membership and keeping the Sreni active and growing. The foremost symbol of the Sreni growth was no doubt the acceleration of membership. From entry and to exist of membership and the overall functioning of the Sreni was based on the rules set by the Sreni dharma. As the induction process of the new members was very systematic, the Sreni obtained lots of popularity and sanctions from the state (Shah 1954). Admission to the Sreni was never an end in itself; rather it is a step to the next level of ownership and responsibilities which the new members acquire in their tenure as a member of the Sreni. Well coming to the financial part of the membership, the new member has to make some payment into the Sreni fund, and then he becomes eligible to share the assets, liabilities charitable endowments and other benefits.

No uniformity of views were evident regarding the sharing, whether it should be based on the contribution made to the general treasury or capital and skill provided by the members. Initially, equal division of the assets was the rule but as Sreni expanded and became an integral part of the society more detailed methods of division evolved (Khanna, p. 15). But in a craft- based Sreni, skilled craftsmen were considered as valued asset, and a detailed system of apprenticeship took place. A hereditary element is sometimes attached to it, as most of the training took place under the guidance of the father to his son (Thaplyal 1972, p. 57). It is also true that this method was not the exclusive method for acquiring the skills, but to be an efficient member of the Sreni, what requires is lot of commitment and sincerity from the side of the prospective member. This process reflects one of the rationales behind its endurance.

11.13 The Apprenticeship Process—The Strength of the Sreni Governance

The apprenticeship process in the Sreni added another flavor to the Sreni functioning and governance. This system entails close and professional relationship between the elder member or the teacher and the student. The training process was very detailed, and the length of the contract could go up to more than ten years (Mookerji 1919, p. 60). It is based on a gurukula system of education, whereby the student resides with the teacher in his residence. Once the student learns the craft during the apprenticeship, he becomes capable of engaging in the occupation. The training process which the student undergoes is not a simple process; rather it invokes lots of sincerity, discipline on the part of the student and the teacher. It is a rigorous process of engagement between the master and student and this was reflected in the craftsmanship of the student. If there is any disruption in the training process from either side, then heavy penalty awaited both the parties. Hence, priority was given to the craft and the process rather than the learner or the imparter of the craft. So high level professionalism was maintained during the training process.

The relationship between the student and the teacher is not just limited to the apprenticeship period, but much more. The teacher is always at the receiving end for imparting training and other services and in the form of gifts accrued by the apprentice's profit from his first venture. Another significant aspect of the apprenticeship was that, it was not always the style and the technique of the master that dominated over the system, but sometimes apprentice's creativity was appreciated independent of any influence by the public (Misra 1975). Interestingly, the newly trained craftsman's engagement with the community begins from the moment it starts displaying its skilled work. The public on their side do not carry any stereotypical attitude of only accepting the experienced person; rather they are open to innovation and new skill and ready to explore new talents. This gesture exemplified trust and faith of the public on the Sreni system.

In the initial stage of the craft learning, the apprentice can showcase his talent with the support from the master and the trainee craftsman can utilize this opportunity to understand the depth of his skill and the receptivity of the clients It also acted as an advantage to the apprentice because he imbibed the special technique used by the master in the craft (Thaplyal 1972, p. 82), and by the end of the training he can become a helper to the master craftsmen imparting training to junior apprentices. The system of apprenticeship became the base of Sreni's credibility to serve as a main agency of manufacturing, banking, and trade activities. The rigorous apprenticeship process shaped the future strategy and sustenance of the Sreni and its members. In fact, the apprenticeship process acted as the strength of the Sreni, as well as the members to play their role efficiently and establish a strong governance system in each spheres of their activity.

It is clear from the above, the significance of Sreni dharma in Sreni governance. Hence, the Sreni dharma prepared a credible ground for the internal governance system of the Sreni. It was evident from the manner in which the most experienced trained the incumbent member. And eventually this earned credibility to the Sreni (Mitra, pp. 16–19) in the larger society.

11.14 Sreni Governance and Social Responsibility

Economics, Religious, Politics, Legal and Community engagement was the core of Sreni functioning. In all these spheres, Sreni performed its role in a socially responsible manner.

11.15 Economics, Ethics, and Social Responsibility

It is evident that Sreni and its members are owners of apt governance skill which they derived from their internal governance system. The apprenticeship process or the autonomous management system bore the testimony of Sreni being an economic, ethical, and social entity. Economics, ethics, and religious inclinations were the reasons behind Sreni gaining an upper hand over its compatriots and establishing itself as socially responsible organization.

Economics is the core of any society, and Ancient Indian society too had economics at the ideological and social level. Business in Ancient India was formalized with an ethical dimension which was based on the concept of dharma. The Sreni dharma being the essence of Sreni's credibility in the society also formed a part of business responsibility. Economic activity of the Sreni formed a part of the tradition of Artha (economic welfare and material gain), but it is a different matter that it is the state's responsibility to cater to the economic needs of the community (Buckingham and Nilakant 2012). The Sreni with the state support carried out its economic duties in an ethical manner. In the early Vedic period, the Sreni's economic potential couldn't flourish much, but in the later vedic period due to several potential factors it's contribution to economic growth of the society became an established fact. The state also recognized the significance of Sreni's or the guilds role in the ethics of wealth creation (Buckingham, p. 96). It was not possible for the king to regulate the economy without the bureaucratic state structure and the Sreni, the community support provided by the Srenis. Hence, the Srenis primarily the merchant ones collaborated with the state within the broader framework of Artha (Majumdar, pp. 25–8). That was not all; merchant Srenis helped the state to ensure mechanisms of wealth creation and conducted labor regulation according to the ethics specified by the Sreni dharma. This ethic though based on profit but benefitted its stakeholders, starting from its consumers, suppliers, the state and the larger community.

11.16 Financial Governance and Social Responsibility of the Sreni

Economics was though the prime reason for its survival, the Sreni activities were not just confined to it. Its direct or indirect involvement in politics or other spheres were possible because of their keenness or interest in it. Also, with no stringent social divisions inside the Sreni system, they conducted themselves without any interference. Their economic skill displayed it. Without any established financial system in place, say like modern banks, Sreni fill the void by playing the role similar to a banking organization. For the economy to grow, an adequate financial mechanism was the urgent necessity, so it became a fertile ground for the Sreni to establish such a system which was a dire requirement for corporate unit like them as well as for the public.

The public relied on Sreni for several reasons. Firstly, the Sreni provided the security that was absent in the socio-political climate of that time for the people. With no secured place to deposit their wealth common people used to bury their possessions under house-floor, riverbanks and sometimes in forests (RayChaudhuri 1953) and the Sreni provided a secured alternative. Secondly, people's reliance on Sreni was that, there was no unified pattern of banking system at that time, individuals and groups flouted their own rules for depositing money and rate of interests and the Sreni acted as a supportive system (David and Foley 1901).

Sreni's advent in the field of banking didn't take them long to provide credit and banking services to the business community, and public at large. In such situations their governance skill proved very handy. This skill of the Sreni attracted customers from both privileged and under-privileged background in the same manner, and not even sparing the high-ranking public servant. It was true that these officials looked for some safe haven to deposit their money, with a social interest (Thaplyal 1972, p. 90). Both public and individual endowments were utilized for charitable, religious and helping the needy, of course with due consent from both the parties.

Interest and the expertise which they gained over a period of time, a lot can be assigned to the common people's faith and acceptance of the Sreni delivery system.

People across varied classes and ranks accepted and utilized the financial services provided by the Srenis. As a result, the Srenis gained a formidable ground in financial matters and the public trusted the Srenis in the absence of any other forums. But the common people never relied on one single Sreni, for they feared that if the Sreni goes bankrupt they will not be able to retrieve the loss. To be in the safer side they deposited their wealth with more than one Sreni, similar to what a shareholder in modern market does by buying shares in many places to survive the rough weather conditions of the market. Public feared that if they totally rely on one Sreni they may lose their hard-earned wealth, when the Sreni goes bankrupt. But such factors didn't stop the public to withdraw their faith from the Sreni system.

Interestingly, the Sreni performed its myriad roles with strict discipline and dexterity and this was possible only because a high-level professionalism was ingrained in its functioning. Such professionalism was apparent when charitable acts were performed as per the wishes of the donors from their common fund account, but a major part of the money was always used for expanding and upgrading their trade. Interestingly, Sreni's never had a uniform policy for interests on deposits. Different circumstances are judged differently. When there is a new party involved, the higher interest is charged on the new party and same rule didn't apply for the original party, and this also proved their financial acumenship.

11.17 Legal Governance and Social Responsibility of the Sreni

It is evident by now that Sreni never feared from taking any responsibility. It existed in Ancient India for many years. It was used for many purposes, as time passed by some of its distinguishing character changed but some remained consistent. It acted as separate legal entity. It had clear cut laws related to property separate from the owners and constructed laws for governing the behavior of its members, sue and be sued in its own name (Khanna 2006). Sreni's command over diverse affairs of the society had made them confident to handle specialized arenas of functioning and execute it appropriately. Handling legal matters and establishing a legal governance system at that time was very challenging. The Sreni did it with much sincerity and skillfully. The Sreni played its legal role with clear rules laid out for its internal functioning and in its dealings with the public. Its legal role takes into account adjudication within the Sreni, its business transactions, community dealings with primary stress on civil matters. The strength of the judicial role of the Sreni lay in its three -tier structure and functions related to it.

Sreni's carried out their judicial functions based on its own laws. These laws were based on Sreni dharma. The internal affairs of the Sreni that were maintained through the Sreni dharma enjoyed a considerable autonomy (Samaddar 1984), and their self-governance pattern of administration also helped in the general administration of the state. The autonomy that the Sreni enjoyed also had the sanction of the state. That is why there was certain degree of non- interference by the state in the activities of the Sreni. Even though legal codes were not uniform across all the Sreni, there was no pressure from the state to maintain so, because Sreni activities varied and so its jurisdictions. The Sreni which were more established had the advantage of being holding strong legal codes, whereas the newly formed ones had to adopt new rules as per their needs.

There were general rules laid out for all the Sreni but individual Sreni have the discretion to establish their own rules specific to the craft. The Sreni law had a strong position in the society, and it was uniformly respected by the members of the Sreni and the state. The sanction against the violation was prioritized than enumerating these laws. This has lot to do with its presence in the society. Sreni laws were not recent in origin, rather they developed over a period of time has established itself as a significant doctrine. It was also implied in the system that no individual Sreni can enact any law as per its convenience; rather rules should go through a due process of evaluation and analysis. It strongly advocated specificity of legal rules for every craft, and stressed on the non-interference from anyone, not even the royalty. Rather it is the duty of the members of the Sreni to acquaint the king with these laws, so that he can refer to these laws while delivering justice to the members or the Sreni if any such case arises. More so, as these laws had the sanction of the law- givers, the state was kept away from such matters. But whenever necessary, the king has the power to ascertain whether the rules applied were in conformity with the sacred law (Katyayana cited in Thaplyal p. 42). The king under three very important situations, can decide which laws should continue and which are to be eradicated, even if it has been there for long, i.e. laws that are dictatorial in character, laws which are immoral and laws inspired by evil motive. The Sreni though had an autonomous jurisdiction in its internal matters, but at times of transgression of rules that might hamper the Sreni dharma, the state's decision remains final. This also makes the Sreni reflect upon their own rules and its implications and remain socially responsible.

11.18 Decentralization and Separate Laws for Business Transaction

Being a business entity, separate rules were advocated for business transaction. Although the state functioned as a centralized body but preferred decentralization at certain level for convenience. For convenience and efficiency, Kautilya, an advocate of centralized system argued for decentralization and creation of a separate office to look into business transactions (Gopal 1964, pp. 896–97). He stressed that the Superintendent of Account's job would entail keeping an account of not only business transactions but also look into the customs and rules associated with it. He has to keep a record of the Sreni transactions as well as customs, and also sets out separate rules for cooperative work, and work done on an individual basis.

11.19 The Co-operative Basis for Business Laws and Sanctions

The principle of co-operation being the primordial force behind businesses of Sreni, so setting the rules for just business transactions was not enough, for Kautilya was aware of business contract and the laws aligned with it, which are also very essential for the stability of the Sreni as well as the state. After all the economic profit benefitted all. Therefore, rules were laid out for equal division of profit between members.

Transgressions of any laws were always taken very seriously. Due to the significance of the Sreni Dharma, strong emphasis was laid on the sanctions associated with its transgression. Those who transgressed contracts without having any serious reason faced severe consequences. To make the process more systematic in the penalization aspect, it was clearly laid out that, if anyone does so for the first time, it was excused as mere negligence, but repetition may lead expulsion from the Sreni itself. The Sreni dharma or Sreni usages being the base of its legal system, the Sreni also stressed upon specific laws for timely sell of the commodities. Here too penalties were specified with transgressions. Because of the co-operative nature and penalization aligned with the sanctions, the corporate law of the Sreni functioned efficiently.

That was not all, Sreni also assumed judicial duties for the general public. For efficient delivery of legal services, it maintained a threefold judicial system. It has to play the role of an adjudicator in the king's court, with the general public and also with the members of the Sreni. Their jurisdiction as common law court remained very popular. Their hold over the community and their legal needs was not for a short span of time, and jurisdiction over such cases was not for a certain period, rather it lasted for long, and stayed on even after the disintegration of the state (Thaplyal 1996). This had nothing to do with the monarchy and its stability, rather it is their hold over legal matters, trust and confidence over their members and the public helped them to endure. There is no doubt that their presence in the royal court strengthened their position with the royalty as well as the public.

The hallmark of the Sreni justice system was the principle of rationality that it was based upon. The strength of the rationality principle is the hierarchical court system. The numerical strength and representation of various interests were cited as the major reason behind such hierarchization (Altekar 1984). But appeal against any decision is done in a progressive manner by referring to the Sreni rules not just in haste. Though there were no clear information regarding the mode of appointment of the courts, but it was assumed that the Sreni head or the executive officers acted as judges in the courts

Sreni's jurisdiction over civil matters was primarily due to their relationship with the community, and hold over community needs, but criminal cases were strictly handled by the state. The civil jurisdiction spanned from handling the misconduct of erring members, their behavior towards the senior members of the Sreni and also overall civil matters of the community. While adjudicating inside the Sreni, it may take the form of adoption of stringent measures against members who displayed hostile behavior towards the highest office of the Sreni, or obstructed colleagues or members from making relevant expression or created dissent amongst the members or divulged the secrets of the Sreni to others.

The decisions taken by the Sreni remained final. Again, coming to the larger community, the Sreni displayed their talent through eloquent jurisdiction, but it is a different matter that, not all issues were reserved for them. Because of their command over community life, civil cases were their purview. But the exclusive jurisdiction of the criminal cases lied in the king's court, whether the erring party is a member of the community or member of the Sreni, because heinous crime tends to disturb the peace and tranquility of the society. And also, the central administration did not want to lose their hold over the larger community, for it was very essential for their bigger political goal.

Sreni's jurisdiction -Even if the jurisdiction system were divided between the king's court and the Sreni court, with criminal matters within preview of the king's court, the civil cases with the Sreni court, but it was not an established rule. Sometimes the civil cases were also tried in the king's court as per the demand and validity of the judgements of the cases. Common people had a choice to file a case to any of the courts directly, though it was not a common trend. A normative pattern was followed that stressed on hierarchization of the courts of appeal, especially with the members of the Sreni, but others were spared, and they have the discretion to appeal to any of the higher courts.

11.20 Trust and Public Faith- the Values of Sreni CSR

Public trust and faith cannot be dissociated from the Srenis, which is why their trade and other related activities fully functioned without much interruption. It was such trust that undoubtedly favored them from other entities of that period. The successful performance of their task, maintaining internal coherence, fairness, honest dealing and faithful discharge of their responsibilities and obligation had helped them to have trust over the public. Srenis also considered such faith over the public very prestigious as it had a charitable purpose (Sircar cited in Thaplayal, p. 95). Srenis considered charity as an important exercise, and important aspects of their business activities. It was considered as crucial as their trade activities. That is why from every profitable venture a certain amount was kept aside for community purpose. In this process the Sreni earned faith from the public which in fact added value to their business

Most of the Srenis have to change location because of the economic demand. But changing of locations didn't affect their unique ethics of internal cohesion, credit, legal relations and liabilities (Mookerji 1919, p. 120)

It is the unity of the Srenis which was of concern to the public rather than the station of its location. In terms of financial endowments, a north-south variation was evident. Some sources reveal that most of the endowments in case of Srenis of northern India were made in cash, but the southern region it was in the form of livestock. These endowments had a religious overtone, in Northern India it favored Buddhist and Hinduism, but South India favored Hinduism.

Despite the religious overtones which varied from place to place, public faith and trust became the cornerstone of Sreni CSR.

11.21 Conclusion

It's clear from the above discussion that an active corporate life existed in Ancient India. The existence of entities like gana, puga, nigama, vrata, samgha and Sreni and their active participation in various spheres of the society along with their core activity displayed the importance of business in society at that time. Srenis outperformed the other entities because of their skills and craftmanship. But most importantly Sreni could perform in all the activities because of their governance system. It is the internal governance system which helped the Sreni to carry out these activities. It's economic and business activities were socially inclined, and a large involvement of the community was evident. Other activities which were directly or indirectly linked to business too were performed in a socially responsible manner and these initiatives were adopted voluntarily.

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Chapter 12
Taxation and Mandatory CSR in India: The Perplexity Persists

Vidhi Madaan Chadda

Abstract Paradigm shift was brought about in the dynamics of Corporate Social Responsibility (CSR) in India vide the Companies Act, 2013. The 2013 Act, mandated certain class of companies to spend 2% of their average net profits of the past three years on CSR activities as enumerated in the *Seventh Schedule*. The said shift from the voluntary to mandatory regime is marked by corporation's choice to strict compliance. The Finance Act, 2014 prescribed that any expenditure incurred by a company assessee on the activities relating to Corporate Social Responsibility referred to in Section 135 of the Companies Act, 2013 shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession. This meant that such expenditure would not be allowed as expenditure under the Income Tax Act. Traditionally, the companies making voluntary donations and those involved in charity were allowed deductions of such contributions under Section 80 of the Income Tax Act, 1961. Much clarity is not accorded to the contributions made by the companies as CSR activity, as tax treatment of activities is varied to an extent. Moreover, the position becomes vexed post the advent of the Goods and Service Tax. Undoubtedly, clarity is sought in this front. The future course of mandatory CSR is dependent upon several implementation issues to be clarified; clarity in the taxation policy being the paramount. The paper has succinctly analysed the present status of CSR spending (relying upon the government data) to exhibit the possible linkages between corporate CSR initiatives and tax policy. The paper has chalked out suggestions for the way forward in untangling the present tax regime vis-à-vis CSR in India.

Keywords Mandatory corporate social responsibility · The Income Tax Act · 1961 · Companies Act · 2013

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12.1 Introduction

Corporate Social Responsibility has become one of the most debated and analysed concepts of corporate regulation today. Corporate Social Responsibility (CSR) is inherently connected to the conduct of a corporation and aims at examining the query as to whether such organisation owes duty towards its shareholders only or whether it extends towards its stakeholders as well (Sahoo 2011).

Researches assert that the "Corporations are places where both individual human beings and human communities engage in caring activities which are aimed at mutual support and unparalleled human achievement." (Solomon 2000; Freeman and Liedtka Freeman and Liedtka 1991).

The concepts of social responsibility of businesses is not new to Indian corporate sector. A large number of Indian businesses have been involved in philanthropic endeavours in one way or the other. The case for CSR in India is long drawn in the wake of the ancient Indian texts which stressed upon the philanthropic activities to be carried by the individuals and the corporate sector. The philanthropic ideologies were obligatory as a part of the religious responsibilities integrated with the external engagement (Sundar 2013).

The Companies Act, 2013 has sought to institutionalize the said philanthropic giving by introducing mandatory provision for CSR. The move of the government stemmed from the growing unrest among certain sections of the society who have not been benefitted by the fruits of rapid economic growth and development which India has experienced in the past couple of decades. This heralding step was lauded as taken in good faith though the India Inc. was perceived to be 'up in arms' against the mandatory spend on CSR (India CSR 2012).

Traditionally, the companies making voluntary donations and those involved in charity were allowed deductions of such contributions under Section 80 of the Income Tax Act, 1961. Hence, the fate of such contributions was clear. Such clarity is not accorded to the contributions made by the companies as CSR activity, as tax treatment of activities is varied to an extent. Moreover, the position becomes vexed post the advent of Goods and Service Tax.

The mandatory CSR regime was apprehended to be marred by implementation debacle as the execution of the CSR policy was left to the companies itself (Venkatesan 2013). The future course of mandatory CSR is hence dependent upon several implementation issues to be clarified; clarity in the taxation policy being the paramount.

The present paper has foremost aimed at identifying the taxation issues that existed in the pre-mandatory CSR regime. The discussion is followed with the Finance Act, 2014 and the taxation issues emerging out of the mandatory CSR regime in India. The paper in the next part has analysed the said issues and attempted to address them. The paper then succinctly analyses the present status of CSR spending (relying upon the government data) to exhibit the possible linkages between corporate CSR initiatives and tax policy.

12.2 Companies Act, 2013: Ushering the Era of Mandatory CSR in India

The history of mandatory corporate social responsibility in India finds its traces in the twenty first Standing Committee on Finance Report on the Companies Bill, 2009 under the chairmanship of Mr. Yashwant Sinha, which was laid down in the houses of the parliament in August 2010. The Ministry of Corporate Affairs whilst accepting the recommendations of the committee for inclusion of such mandatory spend by certain prescribed class of companies fulfilling the threshold mooted for the inclusion of provisions relating to corporate social responsibility in the statute itself. The standing committee also provided for the adequate disclosures by the directors in their report to members as well.

Based on the standing committee's recommendations, it paved the way for Companies Bill, 2011, which provided for inclusion of the clause 135 under the said Bill of 2011 based on the contours drawn in the standing committee report. Encompassing the various litmus tests, then came into force the Companies Act, 2013 (2013 Act), the relevant provision of corporate social responsibility being enforced with effect from 01 April 2014 which incorporated each and every recommendation of the foregoing standing committee reports. It was for the very first time, when in the Rule 2(c) of the Companies (Corporate Social Responsibility) Rules, 2014, the term corporate social responsibility came to be defined under the statute, which means and includes but is not limited to:

i. Projects or programs relating to activities specified in Schedule VII to the Act; or
ii. Projects or programs relating to activities undertaken by the board of directors of a company (Board) in pursuance of recommendations of the CSR Committee the Board as per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.

The enactment of the 2013 Act has ushered in the new era of social responsibility of business. The provision mandating the contribution to be made by certain companies towards CSR activities has caused a paradigm shift in the regulation of corporate responsibility, which until now was perceived as a voluntary action on the part of the corporate houses. Section 135 of the 2013 Act enunciates that it shall be a mandate for every company possessing a certain net worth or turnover to constitute a CSR committee which shall comprise of three or more directors, out of which at least one director shall be an independent director. The said CSR committee shall formulate and recommend a CSR policy for undertaking the activities enumerated under Schedule VII of the 2013 Act.

Schedule VII of the Companies Act, 2013 provides for the activities which may be included by companies in their Corporate Social Responsibility Policies. Activities relating to:

i. eradicating hunger, poverty and malnutrition, promoting healthcare and sanitation including contribution to Swachh Bharat Kosh set up by the Central Government for promotion of sanitation
ii. promotion of education;
iii. promoting gender equality and empowering women;
iv. ensuring environmental sustainability including contribution to Clean Ganga Fund constituted by the Central Government for the rejuvenation of river Ganga;
v. protection to national heritage, art and culture;
vi. measures for the benefit of the armed forces veterans, war widows and their dependants, Central armed Police Forces and Central Para Military Forces
vii. training to promote rural sports, nationally recognized sports, Paralympic and Olympic sports
viii. contribution to the Prime Minister's National Relief Fund or Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and
ix. contribution to incubators funded by the Central Government or State Government or any other agency or PSU
x. rural development projects
xi. slum area development
xii. disaster management.

The Board of such companies is also required to ensure that in each financial year the company spends at least 2% of its average net profits made during the three immediately preceding financial years towards the CSR activities as chosen under the policy. Here the company must give preference to the local areas or the areas where the company operates for spending such amount for undertaking the CSR activities.

However, as per the General Circular No. 21/2014 issued by Ministry of Corporate Affairs dated 18 June 2014 the activities mentioned under the Schedule VII may be considered under the corporate social responsibility spend are mentioned considering the broad aspect of the society, the spend inclusive under the scope of CSR policy are required to be interpreted liberally so as to capture the essence of the law in letter as well as in spirit.

Since enforced from 01 April 2014, there have been various representations made to the Ministry of Corporate Affairs in terms of addressing the bottlenecks that the industry faced in the implementation of one of the decorated and celebrated changes of the 2013 Act.

12.3 Tax Treatment of Charitable Spending Prior to Companies Act, 2013

The introduction of corporate social responsibility under the statute, marked a paradigm shift from a traditional school of thought of corporate philanthropy to a more responsible and accountable approach of social responsibility.

The voluntary spending by the corporates prior to the inclusion of CSR under 2013 Act were flowing out of social accountability as well as more of reputational considerations for these companies. The governments also considered these corporates as the partners in building the nation as well as capacity development of the country. Hence, for raising and increasing such spends by the corporates, the government came up with various tax incentives under the Income Tax Act, 1961 in the form of enhancing vocational skills, scientific research expenditure whether conducted in-house or amount tendered to a research association.

Income Tax Act, 1961 provides for exemption from the income of the charitable trusts, religious trusts, societies and companies incorporated under Section 8 of Companies Act, 2013 (hereinafter collectively referred to as "trusts") registered under Section 12A of the Income Tax Act. These trusts are incorporated with an intent to serve and cater for the charitable purpose and welfare for the society. However, the exemption from categorisation of any sum received not being eligible to tax, is based on the premise that these trusts/institutions serve the charitable purpose and the registration under the said section is valid. Section 2(15) of Income Tax Act, 1961 defines charitable purpose as to include relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest, and the advancement of any other object of general public utility. Provided that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless:

(i) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and
(ii) the aggregate receipts from such activity or activities during the previous year, do not exceed twenty per cent of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year.

Furthermore, the donors to the trusts registered under Secton 12A of the Income Tax Act, directly are not able to claim deduction for the amount of money donated for the application by the trusts. These trusts are also required to obtain a registration under Section 80G of Income Tax Act, in case the assessee intends to have deduction from the gross total income for the sum of money donated, provided the said amount of money is given by way of means other than cash. Hence, earlier corporate assesses could donate moneys to these trusts and enjoy a straight pass through route for availing exemption under Section 80G of the Act.

Section 80G(1) provides a deduction up to 50 and 100% to the expenditures from the payable tax. The provision further enumerates the 'sums' that shall be eligible for deduction under this provision. Contribution by the assessee towards certain funds instituted by the Central Government such as National Defence Fund, Prime Minister Draught Relief Fund, Prime Minister Relief Fund, Jawaharlal Nehru Memorial Fund, Prime Ministers' Earthquake Relief Fund or National Children's' fund, a fund for promotion of sports and games in India. Some of the funds established by the State Government/s are also eligible for deduction under this provision, like a fund to provide medical relief to the poor, any fund set up by Gujarat Government for relief to the victims of earthquake in Gujarat, Andhra Pradesh Chief Ministers' Cyclone Relief Fund.

In the past (i.e. under the pre-mandatory CSR era), there have been various judicial pronouncements which have held that donation or amount expended by the corporates towards the benefit of the society to be allowed as a business expenditure, therefore permitted under the Income Tax Act based on the rationale that the same permits the corporate to be a good corporate citizen, thereby allowing them to enjoy goodwill in the local vicinity (Commissioner of Income Tax v. Madras Refineries Limited 2003).

The grounds wherein the courts have held the amount spent towards corporate social responsibility as a permissible business expenditure:

a. Community assistance programme and welfare measures (Commissioner of Income tax v. Madura Coats Limited 2009)
b. Installation of traffic lights for the purposes of improving the traffic situation for the ultimate benefit of the society at large (Infosys Technologies Limited v. Joint Commissioner of Income Tax 2007)
c. Contributions by a pharma company in the same line of business vide donating to health care society, were allowed as deduction as a business expenditure (Assistant Commissioner of Income Tax v. Ranbaxy Labs Limited 2009).

12.4 Finance Act, 2014: Provision and Effect

With the enforcement of the provisions relating to CSR, a squabble came into the foray as regards to the tax deductibility of such spend incurred by the companies under the Income Tax Act, 1961. Initially the same brought in different school of thought which involved whether the said expenditure is in the furtherance or course of business, however, some mooted for that the said spend be considered as an expense mandated by a law and hence, the such spend should be allowed under the computation of income in the Income Tax Return.

To address, the same and that too much disenchantment of the corporate assesses, vide the Finance Act, 2014, an explanation was inserted to Section 37 of Income Tax Act, 1961 which provided for the taxing of the amount spent in pursuance of Section 135 of Companies Act, 2013 towards Corporate Social Responsibility on the pretext that the said amount of CSR spend is not in furtherance of business as the same is application of income and the objective of CSR is to accommodate the burden of the government in rendering social services to the society under a public private partnership model. The explanation 2 to Section 37 of Income Tax Act, 1961 stated that for the removal of doubts, it is hereby declared that for the purposes of Subsection (1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in Section 135 of the Companies Act, 2013 shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.

This stand of the government through amendment under the Finance Act can lead to a great impact on the corporate spending, as this may prompt the corporate spending being restricted to the expenses being deductible/treated as donation under the Income Tax Act.

The issue of CSR spending and its allowability as deduction under the Income Tax law has been a bone of contention before the taxing authorities. The matter of concern is the practice adopted by the tax authorities of disallowing the deductions of CSR expenditure not only under Section 37(1) but also under Section 80(G) of the Income Tax Act of the eligible donations. Tax authorities' assessment is owing to their contention that CSR spending in accordance with the Companies Act is mandatory and not merely of voluntary nature. Hence, the drafters of the legislation did not contemplate subsidizing CSR by allowing the same to be allowed as deduction under the Income Tax Act. This practice and elucidation are apparent from a number of disputes arriving before various courts on the interpretation of the amendment made through the Finance Act, 2014.

Recently, in *Goldman Sachs Services Private. Limited.* v. *Joint Commissioner of Income Tax*, the Bengaluru bench of the Income Tax Appellate Tribunal (ITAT), remanded back the case for fresh determination as the Assessing Officer disallowed the CSR expenditure under Section 80(G) on the pretext that the spends are a mandate under the law and not a mere volition for the company. The tribunal reiterated the law laid down vide the Finance Act, 2014. In the backdrop of the insertion of Explanation 2 to Section 37(1) of the Income Tax Act, 1961, financial year 2015–16 onwards, the deduction for CSR expenditure is not available under Section 37(1). However, there exists no embargo upon claiming deduction of the CSR spends under Section 80(G) which was the case in the present case. The same bench of the ITAT has on previous instances asserted that the intent of the legislation is not to deprive the taxpayer of the benefit of claim available under Chap. 6 (under Section 80G when all the condition for claiming under the provision is satisfied) just because that is a CSR spend. This interpretation is not only discouraging for the corporations but also leading to double—disallowance which is not warranted (*First American (India) Private Limited* v. *ACIT*; *Allegis Services (India) Private Limited* v. *ACIT*).

12.5 Taxation Issues in Mandatory CSR

The amendment to the Income tax Act, 1961 vide Finance Act, 2014 brought across various issues in the implementation of CSR which were also identified by the high-level committee report formulated by the Ministry of Corporate Affairs (MCA) under the chairmanship of Mr. Anil Baijal. The report provided for the following issues:

a. Companies would be tempted to spend as CSR the expenses which may qualify for tax exemption, thereby leading to restrictions under the CSR practices (Ministry of Corporate Affairs, Government of India, September 2015)
b. Inclusion of contribution to Prime Minister's National Relief Fund may be prompted as a double-edged sword in the wake that the Public Sector Undertakings not being permitted and allowed to spend under the same, however, the said contribution by other corporates would be provide for CSR spend as well as tax exemption being permitted towards such spend (MCA 2015)
c. Funds allocation for CSR in developmental sectors might be prejudiced in the light of no uniform tax policy of CSR spent on eligible services (MCA 2015).

Other issues that have emerged as a part of the implementation of CSR under the category of taxation are as under:

a. There are complexities around the availability of tax exemption to certain spends, while the others do not enjoy a direct tax exemption leading to the corporates being prompted to spend majority part of CSR fund across the activities on the spend enjoying tax exemption;
b. Availability of tax exemptions to corporates for the voluntary spend towards Corporate Social Responsibility
c. CSR activities are permitted to be undertaken directly as well as through implementing partners, however, there is non-applicability of the amount of donation given to the implementing partners, alas, the supplies being undertaken towards the CSR falls under the levy of indirect tax (GST) net. Furthermore, the procurement of such supplies shall not be permitted to be eligible for the availability of input tax credit, on the pretext that the said expense is not in the furtherance of business.

Pursuant to the recommendation of the high-level committee of 2015 (MCA 2015), another high level committee was constituted under the chairmanship of Sh. Injeti Srinivas, Secretary Ministry of Corporate Affairs in the year 2018 (after three years of the 2015 report). The committee aimed to review the progress of the existing legal framework for CSR and propose the way forward for creating a more robust regulatory and policy for implementation of the mandatory regime (MCA 2019). The report affirmed its' consciousness of the lack of uniformity in the tax treatment for CSR expenditures with a caution that this will eventually lead to distortion in the CSR spending. This distortion has given rise to an artificial compartmentalization in the kinds of CSR expenditures, those eligible for tax deduction and those not (Securities Exchange Board of India, Report of the Working Group on Social Stock Exchanges

2020). The high level committee emphasized upon the immediate need to address the distortion, induce transparency into the system to encourage corporations for CSR spending. The report gave following recommendations (MCA 2019):

a. An endeavour must be to make CSR spending deductible from the income of the company for tax purposes.
b. All the activities enumerated under Schedule VII to be subjected to uniform tax treatment and the implementation mechanism must be tax neutral.
c. Inconsistency in application of GST be tackled by treating implementing agencies as partners and not just service providers.

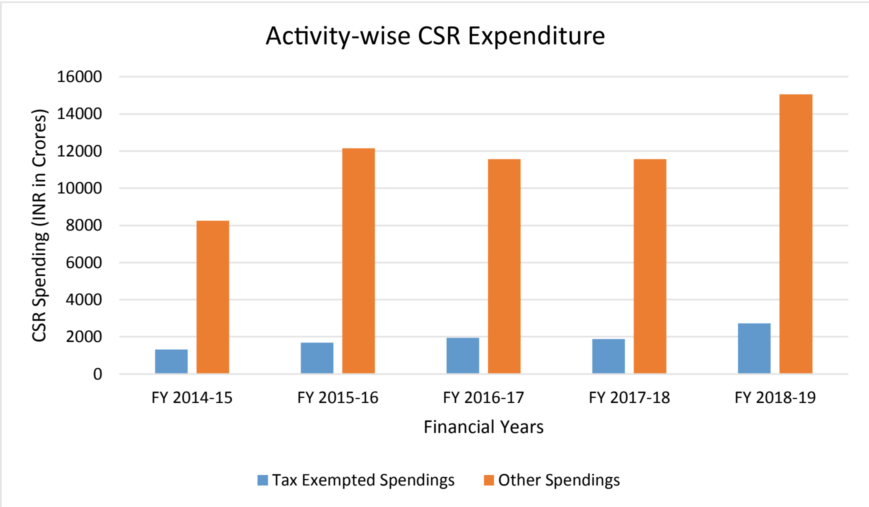
Clarifications from the revenue department is imperative and need of the hour, as recently in the case of *ACIT* v. *Jindal Power Limited*, ITAT Raipur Bench, addressed the issue relating to voluntary spend towards CSR as being allowed as business expenditure and interpreted the amendment in the Finance Act, 2014 only being applicable towards the mandatory spend of CSR and the voluntary spend is outside the ambit of the Explanation stated vide the amendment in the Finance Act, 2014. Levy of GST on the supplies and non-availability of input tax credit thereon, would only be leading towards increase in the cost of supplies and thereby leading to increase in net spending on such procurements in real terms, hence the GST Council should either come up a with a lower tax regime for such distribution of goods or should make available input tax credit on such supplies as well to the corporates leading to the reduction in the overall cost, so that the companies can spend the amount judiciously and it does not merely leads to exaction of another form of tax by the government in the wake of fulfilling a social responsibility under a public private partnership framework for the benefit/upliftment of the society as a whole.

12.6 Are There Linkages Between the Tax Policy and CSR Spending?

Historically, a clear and conducive tax policy is viewed as a determinant for encouraging the businesses to contribute towards society. A favourable tax policy has been one of the factors behind the highest number of charitable foundations in Victoria, Australia and rich bequeathing their fortune to the charity (Sundar 2013).

The policy under the current Indian taxation framework for the implementation of CSR spend seems to have hit the corporates. A look at the CSR data available at the National CSR Data Portal maintained by the Ministry of Corporate Affairs Government of India, indicates this trend. The CSR data portal collates and disseminates the CSR related data filed by the registered companies to the MCA. This portal besides giving details of the total CSR spending also provides details for CSR data State-wise, sector-wise and specific company contributions.

We see a marginal increase in the CSR expenditure in the areas where exemption is available to the corporate spenders under the Income Tax Act upon fulfilment of certain conditions (like contribution to Prime Minister National Relief Fund, rural development, agricultural projects etc.). Comparing the percentage increase in tax-exempted areas to other areas of CSR spending, it is seen that the earlier numbers stood at 13.7% and 12% for the financial years 2014–15 and 2015–16 respectively. The financial years thereafter i.e. 2016–17, 2017–18 and 2018–19 witnessed gradual rise to 14.6%, 15.1% and 15.7% respectively (as can be evidenced in the following graph).



With the spending towards tax exempted/deductible areas going up in percentage terms, the other tax benefit/exempted areas wherein the spending had been undertaken by the corporates could not be ascertained, due to lack of such disclosures embarked by the corporates in their annual report.

The above figures certainly reflect that the CSR spending has really become a matter of concern as well as a board room discussion for the adoption of CSR practices in line with the taxation policy adopted by the companies, with the companies being averse to non-availability of tax deduction/exemption.

The amount of direct spending in the tax exempted government schemes viz. Prime Minister's National Relief Fund has also led to another observation as to its judicious spending by the administrators of such funds as well as distortion in the other areas of spending.

The government for increasing the private partnership in its social initiatives as a part of its national effort, also extended the tax exemption to the other governmental schemes namely Clean *Ganga* Fund and *Swachh Bharat Kosh* which is included in Section 80G of Income Tax Act, 1961 inserted vide Section 22 of Finance Act, 2015 as applicable from April 1, 2015 to increase the spending of the private donors.

The said aspect was also considered by the high-level committee formulated by the Ministry of Corporate Affairs which opined that the said contribution towards the Prime Minister's National Relief Fund as a part of CSR initiative would not be able to keep up the spirit and intent of provision of CSR, as the same would significantly diminish the involvement as well as the sense of accountability of the corporates towards the society (MCA 2015, 2019).

12.7 Conclusion and Suggestions

Therefore, for effective implementation of CSR in the form of social development along with capacity building of the individuals, the government must identify the need for considering the changes to the taxation policy as in the current structure. The change is required as certain expenditure are enjoying the taxation benefit and the others rallying behind with no exemption being made available to them. This perplexity might distort the spending and restrict the spending towards the tax-deductible areas.

The government must rationalise the taxation structure both direct as well as indirect for boosting and encouraging the corporate sector to spend on the areas of national skill importance as well as for furnishing the basic amenities by providing the corporate sector with the taxation benefits. Furthermore, due clarification should also be given in terms of the judicial pronouncements laid out by the Tax Tribunals/Courts for the voluntary CSR spends by the companies.

The government must also strive to hold the said CSR expenditure spent in line with the provisions of Section 135 of Companies Act, 2013 as a spend in the course and in furtherance of business, so that it leads to the reduction in the taxation cost of the benefits that the companies intend to otherwise provide to the actual beneficiary.

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Chapter 13
Social Responsibility Investment: An En-route to Attain Social Responsibility Objectives by the Corporations

Chetna Rath, N. Azhaguraja, and Malabika Deo

Abstract The mindless usage of resources in the name of industrialization has caused several imbalances in the ecology and the environment which has resulted in various natural hazards. This called for an equitable balance between industrialization and environmental protection. The rising environmental concerns and plethora of causes affecting the same has become a debate in the recent years. All the above made the industries to take up 'Corporate Social Responsibility' as a mandate and the same was appropriately brought in the Companies Act 2013 in India. Though the socially concern companies were following voluntary CSR practices, the new Companies Act 2013 made it mandatory so as to impose responsibility on the corporations to protect the environment through CSR practices. Meanwhile, the concept of 'Social Responsibility Investment' is taking strides across the globe as an avenue for deriving financial return as well as achieving ESG (Environmental, Social and Governance) objectives. Investors concerned about environment are presumed to be interested to invest more in a firm adopting CSR as it will serve both the purposes. By making about a 'socially conscious' investment, not only the shareholders but the entire stakeholder community can be benefited. The present paper focuses on significance, evolution of theory and research, social-responsibility screening, investor preference and the future prospects of SRI (Socially Responsible Investment) in India. The methodology adapted is descriptive in nature and data is collected from secondary sources. The study concludes that the significance of Green Investment strategy needs to be popularized to the maximum to bring about an overall positive change in the economy.

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Keywords Corporate social responsibility · Social responsibility investment · Green investment · Companies Act 2013 · India

13.1 Introduction

The conventional philosophy of maximizing profit of the firm has transformed into maximizing wealth in terms of corporate, social, environmental and governance aspect. The new philosophy that has emerged is 'doing well while doing good', has redefined the entire perception of the corporate executives while implementing any business decisions. In the recent years, industries have become the most significant and powerful institution which has the potential to affect the lives of common people. Most importantly, giving back to the society in return of what it has taken from it is not only a challenge but also an obligation of the entire business community. The entire system i.e., all the activities of business should be directed towards maximizing benefits to the people while meeting the ESG (i.e. Environmental, Social and Governance) objectives. In this regard, Section 135 of the Companies Act, 2013 has brought about a new provision relating to 'Corporate Social Responsibility' along with certain disclosure requirements to be fulfilled therewith. Especially in the present Covid-19 era that is affecting millions across the globe, the contribution and significance of CSR has enhanced manifold.

'Social Responsibility Investment' also called as 'green investing' is an investment strategy which considers both financial returns and environmental concerns bringing in an optimistic reformation on the whole. The nature and conduct of the business, the type of investment it makes and its impact on the ESG determine whether the investment is socially conscious or not. Common policies for socially responsible investment include avoiding investment of funds in those companies that produce or sell substances which are harmful to the environment or society (viz. tobacco, alcohol etc.) and thereby lookout for companies which are engaged in proving justice to the society, maintain sustainability practices and work on alternative clean technology. This term also sometimes signifies the practices that seek to minimize negative consequences by screening companies that are included in a portfolio of investment. On the whole, it is a blend of proactive practices like Shareholder Advocacy, Impact Investing and Community Investing.

13.2 Evolution and Present Trends

13.2.1 History

The emergence of the Social Responsibility Investment framework can be traced from the following practices adopted in earlier days:

- Ethical investing has its origin in the early 1600s from the Jewish, Christian and Islamic Traditions wherein money was supposed to be earned ethically.
- Methodism founder John Wesley (as cited in the Use of Money, 1872) stated that people should not engage themselves in sinful trade or profit after exploiting others.
- Gradually, Islamic investors followed suit and avoided investing in companies that were indulged in gambling, abortion and financial institutions that were based on interest.
- In contrast, modern concept of SRI is based on differences in personal, moral and social convictions of investors on an individual basis with continuous campaigns from 1960 onwards.
- The first modern mutual fund of SRI framed in 1971 in US named 'Pax World Fund, wherein, due to opposition of the investors, the investments in weapon contracts were avoided.
- In 1980s, the tragic racism in South Africa was a main point of protests by social investors demanding the diversion of the business to the western countries.
- On 25th April, 1986 the explosion of Chernobyl nuclear power plant in Ukraine had spread cancer deaths through radioactive materials across Europe. Following that, in 1989 US witnessed the worst environmental disaster when the oil supertanker nearby Alaska city spilled over 11 million crude oil gallons.
- The investors were more aware and SRI industry saw a tremendous growth in the US, European countries and rest of the globe.
- Due to emergence of recent corporate scandals and factors like Human Rights, Environmental protection, Personnel relations and corporate governance, have started playing an important role to with respect to screening the SRI investment.
- Recently, to curb the magnitude of crisis caused by the pandemic, impact investing can play a major role predominantly in pharmaceuticals/healthcare, logistics, technology, education etc. to bridge the gap between common masses (ORF Online 2020).

13.2.2 Recent Trends in SRI Investments

13.2.2.1 The Theoretical Context

In contrast to the traditional investment which focuses primarily on financial returns; modern SRI revolves around long-term ethical and sustainable investment strategy. Stakeholders now are giving priority to responsible investing and enhancing the importance of financial market in fostering sustainable development.

- The rationale of ESG (Environmental, Social and Governance) has evolved containing the following dimensions: environmental—resource-depletion, renewable energy, clean-technology, pollution, climate-change; social—human rights,

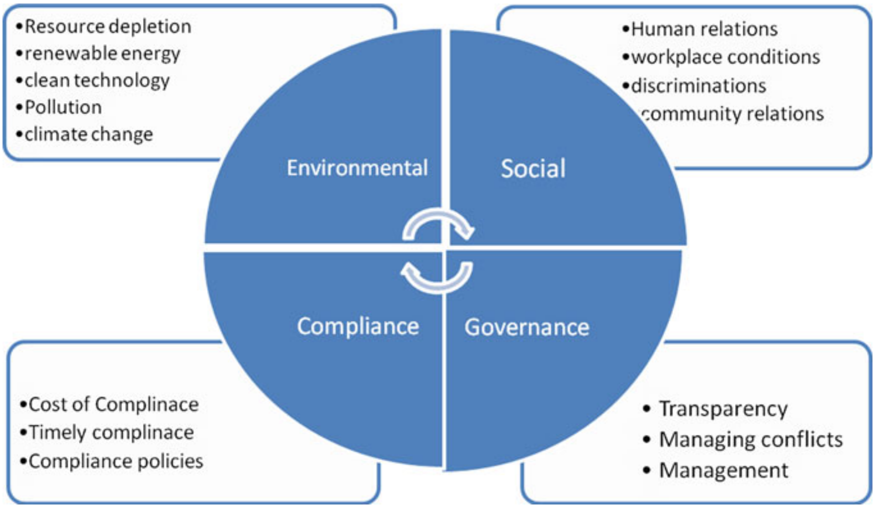

Fig. 13.1 Themes of SRI investment. *Source* Self-compiled by the authors

workplace-conditions, discrimination, community-relations; and governance—compliance, transparent reporting and managing conflicts (Ashley Menezes 2017) (Fig. 13.1).

- Reports indicate that over $2 trillion has been directed towards sustainable investments during 2016–2018, aggregating to almost $9 trillion, or 20% of managed investments.
- In 2016–2018, the impact investing witnessed a growth rate of more than 38% with an increase from $8.7 trillion in 2016 start to $12.0 trillion by the onset of 2018 in total assets under management of USA. The diagram below represents the same (Fig. 13.2).

13.2.2.2 The Research Context

To comprehend the rising research domain of SRI (Renneboog et al. 2008) the authors use the 'Web of Science Core Collection Database' that contains over 21,100 peer-reviewed, high quality scholarly journals published worldwide in about 250 disciplines. On 4th August, 2020, the above database was used to gather academic and research publications indexed in SCI-EXPANDED, SSCI, A&HCI and ESCI on the topic social responsibility investment ranging from 2001 to 2020. The keywords used for basic search can be indicated by the formula:

("Social Responsibility Investment" OR "ESG Investment" OR "Green Investment" OR "Ethical Investment" OR "Impact Investment").

This process generated a total of 334 publications of all document types in English language that contained the above-mentioned words either in their title, abstract or author keywords (Fig. 13.3).

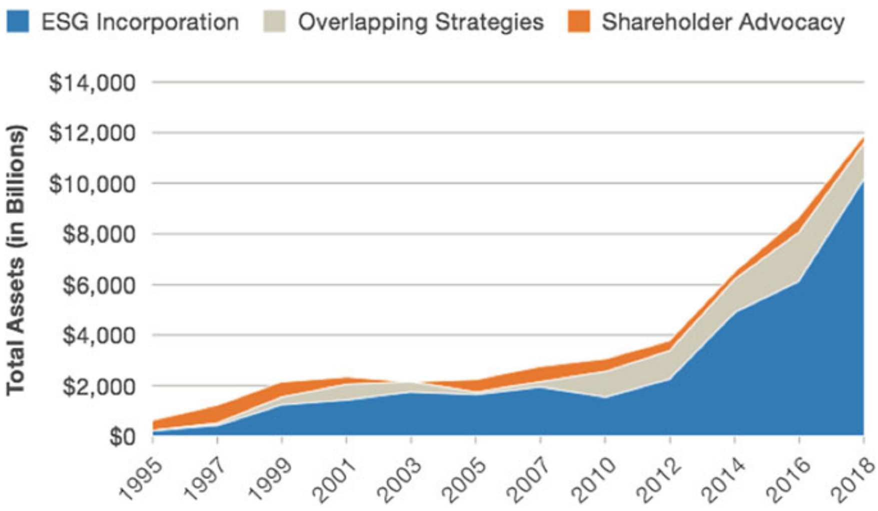

Fig. 13.2 Sustainable and responsible investing in the US (US SIF 2017)

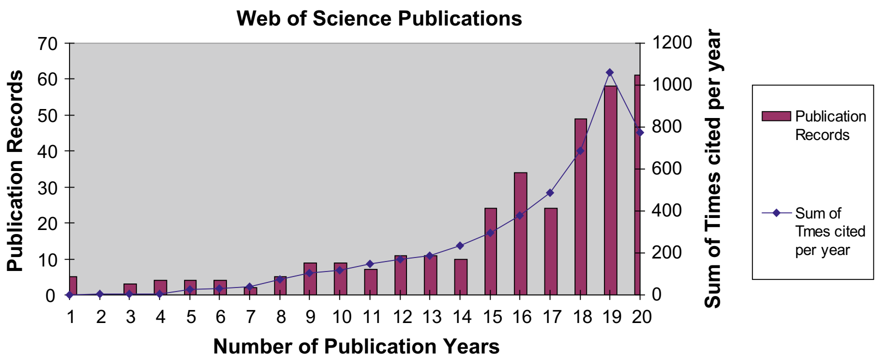

Fig. 13.3 SRI related publications extracted from Web of Science database. *Source* Authors own compilation from the Web of Science database

The above Line-Column graph clearly indicates a rising figure in the number of publications (the Y-axis for publications is mentioned in the left-hand side represented by column diagram in the graph) with 61 records from the year 2020 (i.e. 20th year) accounting for about 18.263% of the total 334 publications. With just 5 publications in 2001 (indicated by 1 in the X-axis) to 58 records last year, the impact investing domain has witnessed a steep rise in research works thereby proving its soaring impact and interest amongst the stakeholders. China (57), USA (54) and England (48) are the top three countries respectively having higher publication counts as compared to other regions. There has also been a significant rise in the annual sum of times the works have been cited (the Y-axis for citations is mentioned in the right-hand side represented by line diagram in the graph) from just 148 in 2011 to 1062 in 2019 resulting to a total of 4,825 citations till date. These highly cited works are considered to be of international repute applied in multi-disciplinary genre as they have a very significant impact in the global context (Zhang et al. 2019). On a whole, it can be strongly opined that responsible investing is the need of the hour as it has immense potential to bring about an overall transformation across every spheres of life.

13.3 SRI—Its Relevance in Indian Context

With a view to bring about a mandate in adopting CSR Practices in India, the following provisions are brought out under Section 135 of the Companies Act, 2013 i.e., the companies whose.

- Net worth exceeds rupees 500 crore (or)
- Turnover exceeds rupees 1000 crore (or)
- Net profit exceeds rupees 5 crore.

shall spend at least 2% of the average net profit of preceding three financial years towards CSR activities (ICSI Study Material-Professional Programme, 2016). This has brought about an exogenous impact on the corporations towards working for the benefit of the stakeholders as well as simultaneously protecting the environment.

The term ‘CSR’ encompasses a broader scope while SRI can be stated as the means of achieving the same (Sparkes and Cowton 2004). While CSR can be stated as the success of the business by striking a balance among the economic, environmental and social issues through various ways that benefits the community on a whole, SRI is the supply of funds to firms that fulfill such social responsibilities through means of investment in stocks and extension of loans.

Social friendly debate has stirred the globe with its rising negative consequences and unhealthy investments. The figure given below depicts various avenues in which investments are made by mutual funds of Investment Forum in UK (Fig. 13.4).

Though in India SRI investment is at a nascent stage, steps are being taken to promote the same. A similar data extraction from ‘Web of Science Core Collection Database’ resulted only about four Indian publications from 2016–2020, with no records from previous years. The search criterion was kept similar, except for the following keywords:

(“Social Responsibility Investment” OR “ESG Investment” OR “Green Investment” OR “Ethical Investment” OR “Impact Investment”) AND “India”.

As a corollary to the slow SRI growth, the Ministry of Corporate Affairs established voluntary guidelines for business in the year 2011, with respect to social, environmental and economic responsibilities etc. As a result in the year 2012, top market capitalized companies started reporting the business responsibility in the annual reports. A research report by Mckinsey, labels India as a ‘testbed of new impact-investment ideas’ as these investments grow at the rate of 14% annually,

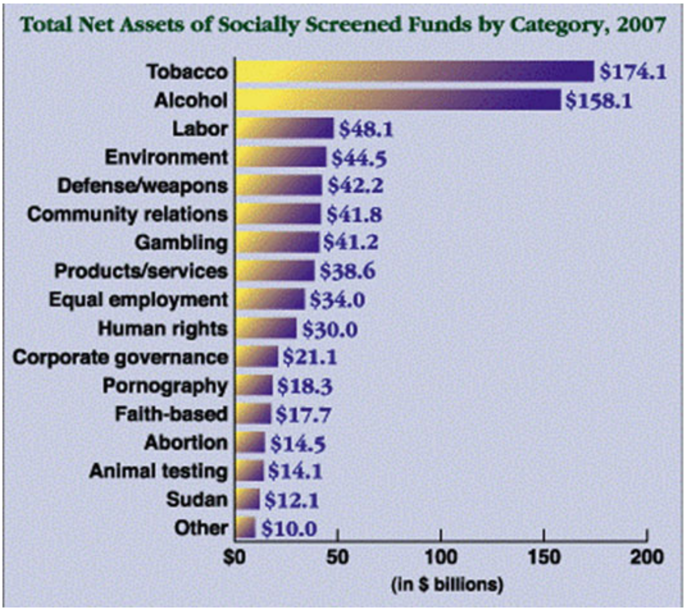

Fig. 13.4 Screens under SRI. Thomas J. Billitteri. (2008). *Volume 18, Issue 29: Can investors do well by doing good*? [Image]. Retrieved from https://library.cqpress.com/cqresearcher/file.php?path=/images/CQ_Researcher/r20080829-socialscreens.gif

giving back an incentive of higher internal rate of return(IRR) (McKinsey Quarterly, 2018). The Global Steering Group for Impact Investment (GSG) and Social Finance Global Network (SFGN) on 14th May, 2018 at New Delhi promoted Social Finance India (SF-IND) which is not for profit intermediary to enhance the Indian impact investment space to register as Section 8 companies under Companies Act, 2013. In the budget speech of July 2019, Finance Minister of India proposed the establishment of Social Stock Exchanges (SSEs) that will also help as a filter by selecting only those entities that create measurable positive social impact and reporting such impact; thus providing a wide option to donors looking to invest in avenues having social impact. With the unprecedented fallout of Covid-19 pandemic, mainstream investment will become more responsible and impact-driven. Although initially corporations might consider it as a goodwill enhancement proposition, the future might set-out 'Impact Investing' as a new regulatory framework altogether, as like the 'CSR mandate' in India (Forbes 2020).

13.4 A Road to Social Responsibility Investment

For the effective implementation of SRI the following guidelines of performance yardstick can be considered:

(1) In order to make the corporation performance measurable, we need to formulate corporate goals. SRI investments act as means to determine the actual performance outcome.
(2) In the long-run, firm value and the social welfare have a direct relationship i.e., while constructing stakeholders framework, the firm has to focus on the maximizing the shareholder value after providing managerial incentives (Tirole 2001).
(3) While considering the shareholder value criterion, it is equally important for the firm to consider the entire stakeholders' of the business rather than concentrating on the shareholders' value creations.
(4) Economic theory predicts that when the management is shielded from anti-takeover mechanisms, they are more socially responsible and hence, sacrifice profits as they are not prone to be captivated by profit maximizing ones. Anti-takeover can be ensured through strong and effective investment practices.
(5) Theories relating to stakeholders and CSR concept have important implications for multi-tasking professionals like portfolio managers, fund managers etc., for pursuing their financial and social objectives which will enhance the potential agency costs and in turn emphasizes on maximizing risk adjusted return of the mangers (Friedman 1970). SRI investors ought to invest in traditional funds which perform better than the modern funds and a portion of such returns of such funds can be donated for the good causes as stated in the conflict-resolution hypothesis (Jo and Harjoto 2011).

13.5 SRI Screens—The Important Benchmark of Investment

This refers to a systematic and collaborative approach for providing due consideration to the variables like economic, social and environmental factors at the time of screening the companies. It's of two types—Negative or Avoidance screening and Positive screening. The basic motto of doing this is to select companies that have minimal negative impact on the environment. It is the screening process that provides leadership in all dimensions of business activities such as human rights, product design and corporate policies. This will in turn, raise the reputation of the industry to compete with the CSR leaders of the globe.

The following list shows details of the same:

A. ***Screens to be avoided***
- Alcohol
- Nuclear Power
- Defense/weapons
- Irresponsible foreign operations
- Gambling
- Abortion/Birth
- Pornography/adult entertainment

- Insurance Cover to unmarried couples
- Health Care and Pharmaceuticals
- Interest based Financial Institutions
- Pork Products.

B. ***Screens to be included***

- Corporate governance
- Renewable energy
- Sustainable business practice
- Labor relations and workplace conditions
- Community involvement
- Shareholder activism
- Animal testing
- Environmental Sustenance
- Biotechnology
- Human rights.

13.6 Conclusion

The environmental calamities by way of pandemic, flood, draught, cyclone etc. have taught the world that they need to be more conscious and give back to the society what they have taken from it. As it is propagated from 'Doing well by doing good'(Nielsen 2014) around 55% of the global consumers over 60 countries are willing to pay more for the products which are environment friendly and around 67% of the employees desires to work in companies which are socially responsible. This indicates that the companies should be more conscious with respect to ESG by way of implementing the principles and practices of Social Responsibility Investment so that the companies can maximize the consumer's satisfaction at the same time protect the environment in which it operates. Though the SEBI and MCA have initiated the concept of national voluntary guidelines, disclosure of business responsibility reporting in the annual report, it is advised that India needs to bring necessary amendment in the existing laws and formulate relevant new laws that would basically improve status of Social Responsible Investment. If the government is ready to provide subsidies and tax benefits to the newly incorporated companies, they would definitely be attracted towards investing in these areas of business. It is also the responsibility of the companies to be more conscious of their investment, environment, social etc., more than expecting subsidies, tax holidays etc., from the Government. Although there are conflicting results regarding the returns, it can be stated that investment having both conventional and non-conventional channels would generate positive NPV. Therefore, it can be concluded that Social Responsibility Investment Strategy is the need of the hour that would properly popularize the requirement of the ecology and the stakeholders.

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Author Index

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