A CORPORATE WORLD RIFE WITH FRAUD

August 15, 2013, 3:35 pm

India Seeks to Overhaul a Corporate World Rife With Fraud

By JEN SWANSON

MUMBAI, India — In the wake of global scandals involving kickbacks and accounting fraud, one unlikely country, India, is aiming to set a tone in overhauling its corporate oversight laws.

This month, the nation's upper house of Parliament passed the Companies Bill, 2012, sweeping legislation meant to overhaul auditing, impose stiffer penalties for fraud and create more government oversight of businesses.

The lower house had passed the bill last year. Once India's president, Pranab Mukherjee, signs it into law, it will replace India's 57-year-old corporate legislation that critics say had failed to keep up with changes in business practices.

India, a nation notoriously rife with graft and bribery, was partly motivated to pass the legislation in the wake of an accounting scandal that has been called India's Enron. In 2009, B. Ramalinga Raju, the chairman of a prominent outsourcing company, Satyam Computer Services, confessed to overstating company assets and earnings by more than $1 billion, and then resigned. The fact that one company could defraud shareholders of such a large sum despite regular audits made painfully obvious the need for greater oversight in corporate India.

But some four years after that startling case, little change in corporate laws had taken place until now.

The new legislation will affect all companies doing business in India, regardless of their size, structure or ownership, including the estimated 8,000 corporations listed on three national stock exchanges.

Yet while hopes remain high that the bill will appeal to foreign investors, and kick-start India's economic growth, nearly a decade of revisions has left a watered-down measure lacking structure. Much of the bill depends on new committees and rules that have yet to be drafted, so legal experts have doubts about its ability to police corporations.

"It started off trying to make things easier for corporates, but somewhere along the line, it became more about corporate governance and transparency," said Nilanjana Singh, a partner at the Mumbai office of AZB & Partners, one of India's leading corporate law firms.

Legislators were further motivated to pass meaningful changes after Reebok India accused two former executives last year of embezzling 8.7 billion rupees, or $157 million. Reebok's parent brand, Adidas, discovered during an audit that its former India managing director and chief operating officer amassed their fortune through years of falsifying sales receipts, faked storage facilities and circular trading.

Businesses say such problems are rife in corporate India. In a 2012 report by the global consulting firm KPMG, more than half of respondents reported that their companies had experienced fraud or theft in the past two years. Most of the respondents considered fraud an inevitable cost of doing

business in this country, and many Indian companies were setting aside a portion of their turnover to offset anticipated losses.

The new legislation will take some time to put in place, but some accounting officials are hopeful that real progress could be made in reforming India's arcane systems. Nitin Kini, a partner at KPMG in India, said he believed that the bill could only bolster India's recent economic woes that have included a free-falling rupee.

"Do we live with the current act and be happy with it, or do we look at this draft of the bill?" he asked. "Between the two, the new bill is good. It is a step in the right direction."

The Companies Bill sets tough sanctions for embezzlement, including mandatory jail time and hefty fines for offenders. To prevent additional cases like Satyam — where Indian auditors failed to notice discrepancies despite auditing the company for years — the measure calls for the mandatory rotation of auditors and their firms.

Among other moves, a new committee, the National Financial Reporting Authority, will be created to prescribe and monitor accounting and auditing standards the first time.

The Serious Fraud Investigation Office, an agency that played a leading role in both the Satyam and Reebok cases, will be empowered to start investigations and frame charges. Until now, its authority had been limited mainly to inspecting documents and was diluted by the bevy of other investigative government agencies, all of which had overlapping areas of authority.

A new judiciary, the National Company Law Tribunal, will be created to allow swifter justice, removing corporate cases from high courts so backlogged that petitions linger there for years. The Company Law Board, a quasi-judiciary panel that also heard cases related to the older act, will be dissolved.

Companies in India will also be required to adopt uniform financial years from April to March. The bill also introduces protections for whistle-blowers, class-action suits, and provisions to prevent conflicts of interest and insider trading.

The new measure allows for greater flexibility in cross-border mergers and acquisitions, but it also requires companies to employ at least one resident director, creating a problem for many foreign-owned companies. Stock buybacks, a favored strategy to bolster share prices that is currently permitted every six months, will be restricted to once a year.

One of the most controversial clauses asks larger enterprises — like those with net profits of at least 50 million rupees, or $815,000 — to donate 2 percent of their net profits to corporate social responsibility programs.

"The problem is that some of the changes they've made are quite retrograde," Ms. Singh said. For instance, the efforts to limit a company's number of subsidiaries didn't address substantive problems, she said. "Why should the government should care how a company structures?"

Bharat Vasani, chief legal and group general counsel for Tata Sons Limited, the holding company behind India's multibillion-dollar conglomerate Tata Group, said the bill had many shortcomings. Among those, he said, it fails to adequately address corporate insolvency, stressing that ailing Indian companies desperately need protections like the Chapter 11 bankruptcy rules in the United States.

Removing the jurisdiction of the High Court was also a mistake, he said, because now the bill depends entirely on the efficiency of the tribunal.

"India's experience with tribunals has not been very great," said Mr. Vasani, explaining that they rarely receive the proper infrastructure, financial support or manpower.

"This entire legislation was drafted by the bureaucracy, and they've never experienced how corporate India functions," he said.

And so far, investors in Indian stocks have greeted the passage of the bill with little enthusiasm. The S.&P. B.S.E. Sensex 500-stock index is down 7.55 percent this year, and little has changed since the passage of the bill this month.

But in time, it may pave the way for greater governance, Mr. Kini, the KPMG partner, said. Other provisions prevent the government from interfering in daily business decisions, he said.

"So in that sense, it simplifies how an organization can govern itself, but also puts enough scope for oversight," he said. "But it will take time."