



INTERNATIONAL LAW
JOURNAL

**WHITE BLACK
LEGAL LAW
JOURNAL
ISSN: 2581-
8503**

Peer - Reviewed & Refereed Journal

The Law Journal strives to provide a platform for discussion of International as well as National Developments in the Field of Law.

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With this thought, we hereby present to you

IMPACT OF SATYAM SCAM ON CORPORATE GOVERNANCE IN INDIA”

AUTHORED BY - ADV. SIDDHI UDAY KULKARNI

ABSTRACT

From Scandal to Safeguard: How Satyam Transformed Governance Norm. (History) On January 7, 2009, Satyam’s founder, Ramalinga Raju, confessed to falsifying financial statements, exposing major corporate governance failures, including weak oversight and compromised audits. This scandal underscored the need for urgent governance reforms in India. The Satyam scandal has made investors really worry, as well as bring into question how companies are governed in India. It showed that auditors, regulators, and the company's board did not do their jobs in finding and stopping dishonest actions. This clearly meant that there was a need for stronger governance rules such as in Satyam, leading to enactments such as the Companies Act, 2013, focusing on being transparent, good audit practices, and boards being accountable. Corporate governance is the way a company is managed and controlled through rules and practices. Good governance makes sure that companies act in a fair, responsible, and honest, hence safeguarding the interest of all those involved The Satyam scam put forward the kind of importance such principles were given because fraud could go unnoticed for many years due to poor oversight and weak ethics. The Satyam case revealed some big concerns in the way companies are run concerning poor oversight, accountability, and rules. One big issue is that the board was not independent enough and the auditors were not honest; hence, wrong actions happened uncontrolled. Secondly, the scandal also came clearly showing how regulators did not watch closely, which in the process let the fraud take on. Making corporate governance stronger by having more accountability, more transparency, and ethical leadership can greatly reduce the chances of corporate fraud. The Satyam scam triggered important changes to improve governance standards, making companies more accountable and clear to their stakeholders. After the Satyam scandal, significant changes were implemented, including stricter audit procedures, increased responsibilities for boards, the necessity for independent directors, and enhanced transparency in financial reporting. These measures are part of the Companies Act, 2013, and the regulations set by SEBI aimed at improving corporate governance and ensuring better oversight in companies This study aims

to investigate the Satyam scam and its effects on corporate governance practices both in India and globally. It will examine the governance issues that contributed to the scam and evaluate the reforms implemented to prevent similar incidents in the future.

[Keywords: Corporate governance, Satyam Scandal, Auditors, Company Dishonesty.]

Introduction

Corporate governance involves the frameworks, rules, and practices that dictate how companies are managed and overseen. It plays a crucial role in ensuring that businesses act ethically and consider the interests of their stakeholders, such as shareholders, employees, customers, and regulators. The Satyam scandal that came to light in 2009 revealed serious deficiencies in corporate governance in India, which resulted in a loss of confidence in the corporate landscape. Additionally, this paper investigates the repercussions of the Satyam scandal on corporate governance practices by outlining the reforms initiated to rebuild trust and accountability in the institution.

The Satyam Computer Services scandal, which came to light in January 2009, highlighted critical weaknesses in India's corporate governance system. Ramalinga Raju, the company's founder and chairman, confessed to years of manipulating financial statements by inflating profits and overstating assets. This fraudulent admission sparked one of the largest corporate scandals in India.

The Satyam fraud exposed significant failures in governance, particularly in oversight and the accountability of the board of directors, as well as the integrity of audits. It was clear that the Satyam board did not carry out its oversight responsibilities effectively. The auditors, tasked with ensuring that financial reporting was trustworthy, did not uphold their end of the agreement. Moreover, this scandal revealed that regulators were not diligent enough in monitoring corporate practices. These shortcomings allowed the fraud to persist undetected for a considerable time, ultimately damaging public trust in the corporate governance system at all levels in the country.

India introduced a series of reforms aimed at strengthening governance frameworks and preventing future fraud. A crucial element of these reforms is the Companies Act of 2013,

which focuses on improving transparency, accountability, and audit practices. It mandates that companies include independent directors on their boards to enhance oversight and fairness. Furthermore, the Act reinforced the fiduciary duties of directors and imposed stricter disclosure requirements for financial statements, aiming to ensure greater transparency in corporate reporting.

In addition, the Securities and Exchange Board of India (SEBI) tightened corporate governance regulations for publicly listed companies. These reforms included enhanced whistleblower protection, stricter norms for auditor rotation, and greater focus on board independence. Together, these measures aimed to rebuild trust in corporate governance, restore investor confidence, and ensure that companies operated ethically.

Overview of Corporate Governance

In India, corporate governance outlines the principles that guide a company's operations, focusing on ensuring that its actions are beneficial to all parties involved, such as investors, executives, customers, suppliers, financial backers, regulators, and the wider community.

Corporate governance refers to a set of systems, principles and guidelines by which a company is governed, as to how the company can be directed or controlled to fulfill its goals and objectives in a manner adding value to the company and also beneficial to all the stakeholders¹

Importance of Corporate Governance –

Corporate governance is essential for holding companies accountable, enhancing their responsibility, and minimizing business risks. It addresses issues of non-compliance with crucial financial and management regulations. Additionally, corporate governance is vital for safeguarding investors from significant losses due to the negligence or dishonesty of corporate leaders. It establishes effective management practices by ensuring clear separation between the roles and powers of company executives and their overseers. Furthermore, corporate governance fosters healthy competition among companies, promoting financial growth. By implementing corporate governance policies, companies can operate transparently, significantly reducing the likelihood of fraud.²

¹ Rebecca Furtado, "The Satyam Scandal and its Effect on Corporate Governance Strategies in India", available at: <https://blog.ipleaders.in/satyam-scandal-effect-corporate-governance-strategies-india/#:~:text=Thus%20corporate%20governance%2>

² Athena Rebello, *Corporate Governance in India: Objectives, History, Regulatory Framework, Examples*, updated June 19, 2024.

Regulatory Framework of Corporate Governance in India- The following are some of the governing bodies deciding and implementing the best practices of corporate governance in India:

- **Companies Act 2013:** This foundational legislation prescribes how companies should operate. It mainly touches on board composition, director duties, and audit committees.
- **Securities and Exchange Board of India (SEBI) Guidelines:** SEBI has rules for listed companies. These rules provide that necessary information be given to the public. This helps keep things fair to those who buy shares in the company.
- **Secretarial standards:** These were put forward by ICSI (Institute of Company Secretaries of India). They govern how board meetings should be conducted along with general meetings, thereby enhancing good practice in corporate affairs while ensuring adherence to laws.³

Provisions of the Companies Act and SEBI Prior to the Satyam Scam

Before the Satyam scam, corporate governance provisions in India were primarily governed by the Companies Act of 1956 and regulations put forth by SEBI (Securities and Exchange Board of India). Although some provisions existed to ensure accountability and transparency, they were not as stringent as post-Satyam regulations.

1. The companies Act, 1956

- a. **Board of Directors** - The Board of Directors has a fiduciary responsibility to shareholders, which means they must prioritize the company's best interests. However, the mechanisms for enforcing this duty were not very strong, and the Act did not highlight the importance of independent directors or diversity on the board. While the Act outlined how directors should be appointed and operate, the measures for holding them accountable were quite limited.
- b. **Disclosure and Transparency** - Companies were required to submit annual financial statements and audit reports. While statutory auditors were supposed to ensure compliance with accounting standards, Satyam's case exposed how auditors could overlook financial misrepresentation.

³ Athena Rebello, *Corporate Governance in India: Objectives, History, Regulatory Framework, Examples*, updated June 19, 2024.

- c. Shareholder Rights - Shareholders had the right to vote and participate in general meetings. Nevertheless, minority shareholders frequently found their influence limited. The Act did offer some protection in cases of oppression or mismanagement through Sections 397 and 398. However, the enforcement of shareholder rights was generally weak, and the existing provisions fell short of preventing significant fraud.
- d. Auditors - Auditors were required to provide opinions on whether financial statements presented a “true and fair view” of the company's finances. However, as seen in the Satyam case, auditing processes were weak, and corporate fraud could go undetected for years.⁴

2. Securities Exchange Board of India

- a. Independent Directors - Clause 49 mandated that at least one-third of the board be composed of independent directors if the chairman was also an executive director. However, independent directors at Satyam were ineffective, highlighting the loopholes in implementing Clause 49.
- b. Audit Committee - Clause 49 also required an audit committee comprising independent directors. The audit committee was supposed to oversee financial reporting, but at Satyam, these committees failed to detect the ongoing fraud, showing the gap between the policy and practice of governance.
- c. CEO/CFO Certification - Clause 49 required CEOs and CFOs to certify the accuracy of financial statements. This certification process aimed to hold executives accountable, but despite this, fraudulent activities like the ones at Satyam continued, indicating a lack of proper checks and balances.
- d. Whistleblower Mechanism - Although Clause 49 encouraged companies to adopt whistleblower policies, there was no strict mandate, and many companies, including Satyam, lacked effective mechanisms for employees to report unethical activities.⁵

The Satyam Scam

1. Background of Satyam Computers –

Satyam Computer Services Ltd., established by Ramalinga Raju in 1987, became one of India's top IT and business process outsourcing (BPO) firms in the late 1990s and early 2000s.

⁴ Companies Act, 1956, No. 1 of 1956, India Code (1956).

⁵ Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, Part III Sec. 4 (2015).

Headquartered in Hyderabad, India, Satyam was crucial in the global IT revolution and helped establish India as a significant IT center. Its swift ascent in the IT services industry was seen as a testament to India's technological capabilities and entrepreneurial achievements.

Satyam's growth was driven by the worldwide demand for affordable IT services, and India's vast pool of talented IT professionals enabled the company to win contracts with multinational corporations. During the 1990s, Satyam experienced rapid expansion, benefiting from India's liberalization policies that welcomed foreign investment.

In 1991, Satyam went public, raising capital that allowed it to scale its operations. By 2001, Satyam achieved a significant milestone by being listed on the New York Stock Exchange (NYSE), becoming one of the few Indian IT companies to trade on a global stock exchange. Satyam continued to expand its services globally, providing IT consulting, enterprise resource planning (ERP), and business intelligence solutions. The company diversified its client base to include Fortune 500 companies, and its presence grew in major markets like North America, Europe, and Asia. By the mid-2000s, Satyam was ranked among the top four IT services companies in India, alongside Infosys, Wipro, and Tata Consultancy Services (TCS).

Satyam's financial performance attracted significant attention from both domestic and international investors. The company reported impressive revenue growth, strong margins, and a robust financial outlook. Satyam's shares were among the most traded on Indian exchanges, and it was included in key indices, further enhancing its reputation in the stock markets. Satyam also ventured into corporate social responsibility (CSR) initiatives, aligning itself with sustainability goals and community development projects, which added to its positive public image.

Satyam was once seen as a symbol of India's growing success. The company received many awards for its innovation, good management, and accountability. For example, Agrawal and Sharma (2009) mentioned that in 2007, Ernst & Young gave Mr. Raju the "Entrepreneur of the Year" award. In April 2008, Satyam was recognized as a leader in corporate governance and accountability by MZ Consult, and in September 2008, the World Council for Corporate Governance awarded Satyam the "Global Peacock Award" for excellence in corporate accountability.

From 2003-2008, in nearly all financial metrics of interest to investors, the company grew measurably, as summarized in Table which is given in following. Satyam generated Rs. 25,415.4 million in total sales in 2003-04. By March 2008, the company sales revenue had grown by over three times. The company demonstrated an annual compound growth rate of 38% over that period. Operating profits, net profit and operating cash flows averaged 28, 33 and 35%, respectively. In addition, earnings per share (EPS) similarly grew, from \$0.12 to \$0.62, at a compound annual growth rate of 40%. Over the same period (2003- 2009), the company was trading at an average trailing EBITDA multiple of 15.36. Finally, beginning in January 2003, at a share price of Rs. 138.08, Satyam's stock would peak at Rs. 526.25: a 300% improvement in share price after nearly five years. Satyam clearly generated significant corporate growth and shareholder value. The company was a leading star (and a recognizable name) in a global IT marketplace.⁶

Table – Performance of Satyam Computers

Particulars	2003-04	2004-05	2005-06	2006-07	2007-08	Average Growth Rate (%)
Net Sales	25,415.4	34,642.2	46,343.1	62,284.7	81,372.8	38
Operating Profit	7,743	9,717	15,714.2	17,107.3	20,857.4	28
Net Profit	5,557.9	7,502.6	12,397.5	14,232.3	17,157.4	33
Operating Cash Flow	4,165.5	6,386.6	7,868.1	10,390.6	13,708.7	35
ROCE (%)	27.95	29.85	31.34	31.18	29.57	30
ROE (%)	23.57	25.88	26.85	28.14	26.12	26

(Source: www.geogit.com)

⁶ Dr. Madan Lal Bhasin, *Revisiting the Satyam Accounting Scam: A Case Study*, 5 Int'l J. Mgmt. & Soc. Sci. Res. 31 (2016),

2. The Satyam Scandal–

Despite Satyam's outward success, problems were brewing behind the scenes. From as early as 2002, Ramalinga Raju, the Satyam founder and chairman started doctoring the financial statements of the company. The intention behind the "adjustments" in the financials was to indicate more revenues, higher profits, and an adequate level of cash at hand. This would, by necessity, project growth without break in the future. This would continue the momentum of high share prices and sustain the investors' trust.

However, The illusion started to fade in late 2008, as the global financial crisis took a toll on the IT sector. Raju faced increasing pressure from lenders and creditors to fulfill his financial obligations, especially as Satyam's sales and profitability began to fall. To add to his troubles, the World Bank investigated Raju's actions and prohibited Satyam from its projects for eight years due to issues with employee benefits.

On January 7, 2009, Mr. Raju, the Chairman of Satyam Computer Services, revealed in a letter to the company's Board of Directors that he had been falsifying the company's financial records for several years. He confessed to inflating Satyam's assets by \$1.47 billion, with around \$1.04 billion in bank loans and cash that the company claimed to possess being nonexistent. Satyam also understated its liabilities and inflated its income in nearly every quarter to satisfy analysts' expectations. For example, the results announced on October 17, 2009, overstated quarterly revenues by 75% and profits by 97%.

Mr. Raju, together with the global head of internal audit, engaged in several fraudulent practices. According to Willison (2006), Mr. Raju utilized his personal computer to generate counterfeit bank statements, which artificially boosted the balance sheet with fictitious figures. He also exaggerated the income statement by claiming interest income from these bogus bank accounts. Furthermore, Mr. Raju confessed to establishing 6,000 fake salary accounts, which he exploited to siphon off company funds after the deposits were made.

The global head of internal audit contributed to the fraud by creating fake customer identities and generating fraudulent invoices to inflate revenue. This individual also forged board resolutions and illegally secured loans for the company.

3. Role of Auditor in Satyam Scam-

PricewaterhouseCoopers (PwC), the global auditing firm, conducted audits for Satyam from June 2000 until the fraud was revealed in 2009. PwC faced heavy criticism for not uncovering the fraud, especially regarding the \$1.04 billion in “non-interest-bearing” deposits listed on Satyam’s balance sheet. Accounting experts pointed out that any prudent company would have either invested this money or returned it to shareholders, which should have raised a clear "red flag" for auditors that warranted further scrutiny. However, it seems that PwC did not independently verify these deposits with banks.

The Satyam fraud continued for several years, with the company repeatedly inventing fake income sources to meet the expectations of analysts. Notably, Satyam paid PwC twice the standard audit fee, which raised concerns about possible complicity. While PwC conducted nearly nine years of audits without detecting the fraud, Merrill Lynch uncovered it in just ten days during their due diligence. This discrepancy indicated either a serious lack of competence on PwC's part or potential collusion with Satyam.

A variety of factors contributed to the Satyam fraud, such as greed, a desire for rapid corporate growth, a lack of transparency in financial reporting, a strong focus on keeping stock prices high, executive incentives, and ineffective oversight from independent directors and audit committees. Additionally, failures in both internal and external audits, aggressive tactics from investment banks and rating agencies, and a weak whistle-blower policy played crucial roles in allowing the fraud to persist unnoticed.⁷

The scam brought out several loopholes in the Indian corporate governance structure, viz., unethical conduct, fraudulent accounting, insider trading, oversight by auditors, ineffectiveness of the Board, failure of independent directors and non-disclosure of material facts to the stakeholders.⁸

After – Effects of Satyam Scam –

1. **Role of Regulatory Bodies** – The role of regulatory bodies in the Satyam scam, especially regarding corporate governance, was vital in tackling the failures that enabled the

⁷ Agrawal, S. and Sharma, R. (2009) Beat This: Satyam Won Awards for Corporate Governance, Internal Audit.: <http://www.vccircle.com/news/technology/2009/01/09/beat-satyam-won-awards-corp-governance-internal-audit>

⁸ Ramya S. R., *Ethics of Auditors – A Case Commentary on Satyam Scam*, 28 *Supremo Amicus* 1 (Jan. 2022).

fraud and in enacting reforms to avert similar occurrences in the future. Here are the main functions and actions undertaken by regulatory bodies:

1. Securities and Exchange Board of India (SEBI)- SEBI initiated a comprehensive investigation to determine the extent of the violations by Satyam's management. This inquiry centered on the manipulation of financial statements that deceived investors and regulatory bodies over several years. SEBI closely examined the company's accounting practices and the involvement of auditors, especially PricewaterhouseCoopers (PwC), which did not identify the fraudulent activities during its audits. This investigation was vital for understanding how such significant financial misreporting could remain undetected for so long and how it eroded investor trust in the integrity of financial markets.

In 2014, the Securities and Exchange Board of India (SEBI) amended the Listing agreement to include provisions relating to:

- Establishment of vigil mechanism
- Role of audit committee in case of suspected fraud or irregularity
- Role of CEO and CF pertaining to financial reporting and disclosure to the audit committee.

In 2015, SEBI framed the LODR - SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 that is applicable to all listed companies and provided for stringent guidelines relating to reporting/ disclosure of material events and actual and suspected fraud.⁹

2. The Ministry of Corporate Affairs (MCA)- MCA responded to the Satyam scandal by issuing Voluntary Guidelines for Corporate Governance in 2009, based on the recommendations of a task force led by former Cabinet Secretary Naresh Chandra. These guidelines are as follows –

- Independence of directors
- Roles and responsibilities of audit committees
- Roles and responsibilities of Board of companies
- Whistleblower policies
- Separation of offices of Chairman and CEO for independence
- A system of checks and balances
- Terms and conditions of appointment of directors

⁹ Ramya S. R., *Ethics of Auditors – A Case Commentary on Satyam Scam*, 28 *Supremo Amicus* 1 (Jan. 2022).

- In 2010, SEBI amended the listing agreement to include the provision dealing with the appointment of CFO

The separation of the roles of the Chairman and the Chief Executive Officer (CEO) is a strategic decision aimed at improving board independence and minimizing the concentration of power in one person. This structural adjustment was meant to establish a more effective system of checks and balances within organizations, allowing boards to maintain independent oversight of management decisions. By promoting these best practices, the MCA sought to raise governance standards and avoid the repetition of similar corporate scandals in the future.

3. Companies Act 2013 - The **Companies Act, 2013**, introduced to replace the Companies Act of 1956, brought sweeping changes to improve corporate governance and accountability in India. It was enacted after corporate fraud i.e. Satyam scandal, which exposed significant lapses in transparency, oversight, and financial integrity in Indian corporations. Here's a detailed breakdown of key provisions related to corporate governance, including specific sections of the Act:

1. Independent Directors (Section 149)

- **Mandate:** The Act mandates the appointment of independent directors on the boards of listed companies and certain classes of public companies. The role of independent directors is critical in ensuring that the board makes unbiased decisions that protect the interests of shareholders and other stakeholders.
- **Requirement:** Every listed company is required to have at least one-third of the total number of directors as independent directors. In the case of unlisted public companies, if they meet certain thresholds related to share capital, turnover, or outstanding loans, they are also required to appoint independent directors.
- **Duties and Responsibilities:** Independent directors are tasked with overseeing the operations of the company without being influenced by its management. They ensure that decisions are taken in an ethical manner, assess risks, and ensure legal compliance.
- **Role of Independent Directors:** The Act defines the role of independent directors to include upholding integrity and credibility, ensuring transparency, protecting minority shareholders, and reviewing the performance of management.¹⁰

2. Audit Committees (Section 177)

Section 177 mandates the formation of audit committees for listed companies and certain

¹⁰ The Companies Act, No. 18 of 2013, § [149], India Code (2013).

classes of public companies. The committee must consist of a minimum of three directors, the majority being independent directors.

- At least one member should have financial expertise.
- The committee oversees financial statements, internal audits, related-party transactions, and fraud detection.¹¹

3. Corporate Social Responsibility (CSR) (Section 135)

- **Mandate:** India became one of the first countries in the world to introduce mandatory Corporate Social Responsibility (CSR) spending through Section 135 of the Companies Act, 2013. The law requires companies meeting certain financial thresholds to contribute a portion of their profits to CSR activities.
- **Applicability:** CSR provisions apply to companies with:
 - A net worth of ₹500 crore or more,
 - A turnover of ₹1,000 crore or more, or
 - A net profit of ₹5 crore or more during any financial year.
- **CSR Committee:** Eligible companies are required to form a CSR Committee, comprising at least three directors, with at least one independent director. The committee is responsible for formulating the CSR policy and overseeing its implementation.
- **CSR Spend Requirement:** Companies are required to spend at least 2% of their average net profit from the previous three financial years on CSR activities. If the company fails to meet the required expenditure, it must disclose the reasons for not spending in its board report.
- **CSR Activities:** The Act provides a list of activities that qualify as CSR, including eradicating hunger and poverty, promoting education, gender equality, environmental sustainability, and contributions to government initiatives.¹²

4. Fraud Prevention and Whistleblower Protection (Section 177(9) and (10))

- Section 177(9) and (10) of the Act introduces Whistleblower Mechanisms for listed companies and other prescribed classes of companies. These provisions ensure that employees have the opportunity to report unethical practices or financial fraud without facing retaliation from the company. The establishment of such mechanisms reflects the importance of accountability and transparency in corporate governance.

¹¹ The Companies Act, No. 18 of 2013, § 177, India Code (2013).

¹² The Companies Act, No. 18 of 2013, § 135, India Code (2013).

- The Audit Committee is tasked with ensuring that the whistleblower mechanism is functioning effectively and that complaints are properly investigated.¹³

5. Board Accountability (Sections 134 and 166)

- Section 166 of the Companies Act lays down the duties of directors to act in the best interests of the company, its employees, shareholders, and the community. Directors are required to exercise their duties with care, diligence, and in good faith.
- Section 134 mandates that the board of directors provide a Directors' Responsibility Statement in the board's report. This statement affirms that the board has taken proper care in preparing the company's financial statements and that they provide a true and fair view of the company's financial condition. It also affirms that the company has implemented proper internal financial controls.

Conclusion –

The Satyam scandal marked a turning point in India's approach to corporate governance, revealing significant weaknesses in the regulatory framework. Prior to the scandal, the Companies Act of 1956 provided a basic structure for corporate regulation, but it contained numerous loopholes that were taken advantage of due to poor enforcement, inadequate oversight, and a lack of focus on transparency and accountability. The Satyam case highlighted the shortcomings of corporate governance practices, such as flawed audits, ineffective boards, and insufficient regulatory oversight.

Ramalinga Raju's confession in 2009, where he admitted to years of financial manipulation, sent shockwaves through investor confidence both in India and abroad. It underscored how corporate fraud can thrive without strong governance structures, independent oversight, and effective regulatory enforcement. The case revealed the shortcomings of auditors, directors, and regulators in detecting or preventing such fraud, raising serious concerns about the integrity of the system that oversees India's corporate sector.

In response to the scandal, the government and regulatory bodies implemented major reforms to restore public confidence and enhance corporate governance standards. The Companies Act of 2013 marked a significant milestone, introducing several important changes such as the requirement for independent directors, the formation of audit committees, mandatory corporate

¹³ The Companies Act, No. 18 of 2013, § 177(9) and (10), India Code (2013).

social responsibility (CSR) spending, and improved disclosure requirements. These reforms aimed to increase board accountability, strengthen audits, and promote greater transparency in corporate operations. Furthermore, regulatory agencies like SEBI (Securities and Exchange Board of India) rolled out stricter regulations to bolster corporate governance and ensure more effective financial oversight.

While corporate governance in India has significantly improved since the Satyam scam, the scandal serves as a reminder of the importance of continuous vigilance, ethical leadership, and the need for regulatory bodies to adapt to evolving challenges in the corporate world. The Satyam case not only reshaped India's corporate governance framework but also reinforced the global significance of strong governance standards in maintaining trust in capital markets and business operations.

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