

# Corporate Disclosures-The Road Ahead



**T.V. Mohandas Pai**  
Director & Member of the Board  
Infosys Technologies Ltd.

Peter Drucker says, "Management is doing things right; leadership is doing the right things." In every company, management has the obligation to disclose adequate information to enable their stakeholders to take appropriate decisions. The obligation is part of their trusteeship function and is determined by law, by regulations and also by best practices.

Good companies go beyond law and regulations and ensure that their stakeholders are never short of the needed information. In fact, disclosure and transparency have become competitive advantages as they enhance brand value.

The information disclosed should be relevant, easily understandable and reliable to make a meaningful assessment of prospects and also for purposes of comparability. Disclosures create trust between managements and stakeholders. In fact public markets are based on information flows and disclosure. Better disclosure leads to more efficient markets. Even if a disclosure is not read by investors the fact that a disclosure is being made available in the public domain acts as a good check against any wrongdoing.

Currently companies in India are governed by various regulations. These include Companies Act and Companies (Accounting Standard) Rules, 2006, disclosures as per Schedule VI of the Companies Act, the disclosure requirements of the Institute of Chartered Accountants of India (ICAI) and in addition, companies listed on stock exchanges also have to comply with the requirements of SEBI.

## **Significant Milestones in Corporate Disclosures**

Corporate Disclosures have gained significant momentum in India in the recent past. Key milestones which have enhanced transparency in Corporate Disclosures include:

1. Formation of a Committee on Disclosures and Accounting Standards (SCODA), by SEBI in late 2006 to review the continuous disclosures requirements under the listing agreement and to provide inputs to the ICAI for evolving new accounting standards and review the existing ones, wherever required in order to make disclosure standards and accounting practices at par with the international practices.

## **Development of Integrated Disclosures:**

A listed Company is required to comply with the disclosure norms under the Companies Act, 1956, SEBI Guidelines and Regulations and the Listing Agreement of Stock Exchanges. Currently the initial disclosures required in a prospectus are far more detailed compared to the annual and continuous disclosures made by Companies.

To achieve the objective of standardizing and streamlining corporate disclosures, a Sub-committee on Integrated Disclosures released a draft report on Integrated Disclosures in January 2008. They have made recommendations on integrating initial disclosures made under an offer document with the continuing disclosure requirements by a listed company. The draft report contains improvements to make information and disclosures more transferable and fungible. Fungibility of information between initial disclosures and continuous disclosures would reduce the cost of compliance. However the final requirement is still awaited.

This integrated disclosure requirement is consistent with the U.S. SEC disclosure norms providing a comprehensive disclosure list in the form of Regulation S-K (for non-financial information) and Regulation S-X (for financial information). Companies are required to adopt the relevant disclosures as applicable to them.

2. Introduction of a wide range of corporate governance norms with regard to Insider trading in SEBI (Prohibition of Insider Trading) Regulations 1992. On March 4th, 2008, SEBI put up a consultative paper for public comments, awaiting final requirement, proposing further amendments including the following improvements on disclosures:
  - Under the present SEBI (Prohibition of Insider Trading) Regulations, 1992 the shareholder/director/officer of a listed company is required to disclose to the company information regarding the shareholding or voting rights within 4 working days of receipt of intimation of allotment of shares or the acquisition or sale of shares or voting rights or of becoming the director or officer of the said company, as the case maybe. The company in turn is required to disclose this to the Stock Exchanges, on which the company is listed, within five days. Thus, on a particular occasion, a total of 9 days may pass before price sensitive information is disseminated to the public.
  - As per SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 the acquirer is given 2 days time to inform the company and the stock

exchange about the acquisition of shares after a certain limit is breached as specified in the said regulation. Stock Exchanges in turn are required to “immediately” display the said information on the trading screen, the notice board and on its website.

- In line with SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997, it is proposed that the time gap between the date of transaction and the date of dissemination of the information by the stock exchange may be reduced from nine days to two working days by making necessary amendments to the relevant provisions of Insider Trading Regulations. This would make it mandatory for a person to report the transactions within one working day of trading to the company and company in turn shall inform the stock exchanges, where the shares are listed, within one working day of receipt of information. The Stock exchanges shall ensure immediate dissemination of information to the market.
3. The ICAI on request by the Ministry of Company Affairs (MCA) is considering revising Schedule VI disclosures, in the Companies Act, 1956, as regards simplification of presentation, removal of unwanted and outdated disclosures, harmonization of disclosure requirements in accordance with Accounting Standards and addressing international disclosure requirements. It also aims at minimization of disclosure requirements for small and micro companies through principle of abridgement (i.e., creating a saral document), incorporating flexibility in format to facilitate amendments. However the final reports are still awaited.
4. Major recommendations on disclosures brought in this decade by The Accounting Standards Committee of SEBI are as set out below:
- Additional disclosure norms had been prescribed and also half yearly results had been subjected to a ‘Limited Review’ by the Auditors with effect from half year ending March 31, 2000.
  - In order to harmonize the disclosure requirements under the Listing Agreement and the Accounting Standards issued by Institute of Chartered Accountants of India (ICAI), it had been prescribed that the Cash Flow Statement being disclosed by Companies in terms of Listing Agreement should be prepared in accordance with the relevant Accounting Standard.
  - The Committee had emphasized the need for formulation of accounting standards on Consolidation of Accounts, Segmental Reporting, Deferred Taxation and Related Party Disclosures which had urged the ICAI to expedite the issue of Accounting Standards on the above.
5. SEBI issued the (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines,

1999 which was effective for all stock option schemes established after June 19, 1999. This Guideline mandated a number of disclosures on the options granted to employees in the Directors Report including information of Total Grants authorized, Pricing Formula on the date of grant, any variation in terms, Options granted, vested, exercised and forfeited during the period together with their weighted average exercise prices and related EPS information.

#### ***A comparison of Disclosure requirements in India with the International Best practices***

1. Item 303 of Regulation S-K issued by SEC requires a company's management to discuss the company's financial condition and results of operations, namely Management Discussion & Analysis (MD&A). MD&A gives an opportunity for companies to explain the significant variations in their operations.

The SEC has introduced certain additional disclosures in MD&A including disclosures on Off-Balance Sheet financing and contractual obligations, Non-GAAP financial information, known trends in business and Liquidity and Capital Resources.

Currently Clause 49 of the Listing Agreement requires Companies listed in India to report a section on Management Discussion and Analysis in their Annual Report.

MD&A requirements, as mandated by Clause 49, currently require the following disclosures, including a specific disclosure in the financial statements together with appropriate management explanation when accounting treatments other than those prescribed in Accounting Standards are followed:

- Industry structure and developments.
- Opportunities and Threats.
- Segment-wise or product-wise performance.
- Outlook
- Risks and concerns.
- Internal control systems and their adequacy.
- Discussion on financial performance with respect to operational performance.
- Material developments in Human Resources / Industrial Relations front, including number of people employed.

However the present requirements are still less comprehensive as compared to U.S. SEC requirements. Clause 49 may be suitably modified to include additional disclosures.

2. SEC released its final rule in August 2006 on Executive Compensation and Related Person Disclosure which include disclosures on director compensation, related person transactions, director independence and other corporate governance matters. These changes affected the disclosure in proxy statements, annual reports

and registration statements, as well as the current reporting of compensation arrangements.

These amendments inter-alia included the following additional disclosure requirements:

- Item 404(a) Introduces a General Disclosure Requirement for Related Person Transactions, Including Transactions Involving Indebtedness. Item 404(a), as amended, consists of a general statement mandating that a company provide disclosure regarding any transaction:
  - since the beginning of the company's last fiscal year, or any currently proposed transaction;
  - in which the company was or is to be a participant;
  - in which the amount involved exceeds \$120,000; and
  - in which any related person had or will have a direct or indirect material interest.
- Item 404(b) requires disclosure of the Policies and Procedures dealing with the review, approval or ratification of Related Person Transactions.
- Item 407 of Regulation S-K, consolidates the Corporate Governance disclosure requirements which include:
  - Companies that are listed issuers (or applied for listing) on a national securities exchange or on an automated inter-dealer quotation system of a national securities association and that have requirements that a majority of the board of directors be independent, are required to identify their independent directors and director nominees, as well as any members of the compensation, nominating, and audit committees that are not independent.
  - Companies that are not listed issuers have to disclose their independent directors and director nominees, as well as any members of the compensation, nominating, and audit committees that are not independent.
  - Amendments in the disclosure requirements regarding the audit committee and nominating committee include elimination of the requirement to deliver audit committee charters to security holders if the charters are posted on their websites.
  - New disclosures regarding the compensation committee that are similar to the disclosures required for audit and nominating committees of the board of directors. Companies must state whether the compensation committee has a charter, and whether they disclose the charter through their website or proxy materials. Item 407 also requires that companies describe their processes and procedures for the consideration and determination of executive and director compensation, including:
    - the scope of authority of the compensation committee (or persons performing the equivalent functions);

- the extent to which the compensation committee (or persons performing the equivalent functions) may delegate any authority to other persons by specifying what authority may be so delegated and to whom;
- any role of executive officers in determining or recommending the amount or form of executive and director compensation; and
- any role of compensation consultants in determining or recommending the amount or form of executive and director compensation, identifying such consultants, stating whether such consultants are engaged directly by the compensation committee (or persons performing the equivalent functions) or any other person, describing the nature and scope of their assignment, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement.

Currently in India disclosures for related parties and compensation disclosures are mandated by Companies Act and by Clause 49 of the Listing Agreement. The following are the key disclosure requirements:

- Clause 49 of the Listing Agreement mandates certain disclosures to the Audit Committee but not in the Annual Report. These include general disclosures of related party relationships and material related party transactions.
- All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company shall be disclosed in the Annual Report.
- Following disclosures on the remuneration of directors are mandatorily required the section on the corporate governance of the Annual Report:
  - (a) All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc.
  - (b) Details of fixed component and performance linked incentives, along with the performance criteria.
  - (c) Service contracts, notice period, severance fees.
  - (d) Stock option details, if any and whether issued at a discount as well as the period over which accrued and over which exercisable.
- Companies need to publish their criteria of making payments to non-executive directors in their annual report. Alternatively, they may put up on their company website and draw a reference thereto in the annual report.
- Companies are required to disclose the number of shares and convertible instruments held by non-executive directors in the annual report.
- Non-executive directors are required to disclose their shareholding (both own or held by / for other persons on a beneficial basis) in the listed company

in which they are proposed to be appointed as directors, prior to their appointment. These details are required to be disclosed in the notice to the general meeting called for appointment of such director.

- Further Companies are required to include only a report on non-compliance with the Corporate Governance Requirements as given in the Clause 49 of the Listing Agreement separately in the Annual Report.

As evident, present requirements in Clause 49 on related party transactions and compensation disclosures do not mandate complete disclosure but require primarily disclosures for non-compliance. Such requirements may be enhanced to include disclosures as introduced by SEC, as may be appropriate in the Indian context. These disclosures would boost investor confidence.

1. International Financial Reporting Standards have introduced new disclosure standards including those on Financial Instruments. Complex transactions in today's world make such disclosures imperative in understanding the potential risks of Companies. ICAI has issued Accounting Standards 30, 31 and 32 which are in line with the relevant International Accounting Standards however those are yet to be effective. These would enhance the quality of financial reporting in India.

2. SEC had initiated a Voluntary Filing Programme for Companies to file its statements in XBRL format. SEC has taken steps to convert all the filings and entire EDGAR system to interactive format. The eXtensible Business Reporting Language (XBRL) codes have already been written for most industries.

- Investors who seek specific information directly from the source must often manually search lengthy corporate annual reports. Even if these documents are online, they are often digital blobs with limited search capability. Interactive data pinpoints the facts and figures trapped in today's often lengthy disclosure documents, allowing investors to immediately pull out exactly the information they want, and instantly compare it to the results of other companies, performance in past years, industry averages, whichever way the investor wish to slice and dice the data.
- Interactive data, which will give every number in a prospectus or proxy statement a life of its own, will vastly improve the quality of analysis that's possible for investors and their intermediaries.
- Interactive reports filed with Securities Exchange Commission can be viewed on [www.sec.gov](http://www.sec.gov)

This option is being currently considered amongst the various regulators in India who are developing taxonomies in their own regime.

5. SEC Advisory Committee on Improvements to Financial Reporting issued a Draft report on February 14, 2008. This report is presently under discussion with SEC. This report addressed areas of potential improvement including the following salient disclosure requirements:

- XBRL-Gradual Phase in of Interactive Disclosure Technology to enable investors easily access company information without imposing an untimely burden on small companies.
- Corporate Website Information-The SEC should issue a new comprehensive interpretive release regarding the use of corporate websites for disclosures of corporate information, which addresses issues such as liability for information presented in a summary format, treatment of hyperlinked information from within or outside a company's website, treatment of non-GAAP disclosures and GAAP reconciliations, and clarification of the public availability of information disclosed on a reporting company's website.
- Use of executive summaries as an integral part of Exchange Act periodic reports- An executive summary included in the forepart of an Exchange Act periodic report may provide investors with an important roadmap to the company's disclosures located in the body of such a report.
- Disclosures of key performance indicators (KPIs)- The Enhanced Business Reporting Consortium, has stated that the value drivers for a business can be measured numerically through KPIs or may be qualitative factors such as business opportunities, risks, strategies and plans, all of which permit assessment of the quality, sustainability and variability of its cash flows and earnings. KPIs include supplemental non-GAAP financial reporting disclosures that can improve disclosures by public companies. KPIs are leading indicators of financial results and intangible assets that are not encompassed on a company's balance sheet.
- Improved quarterly press release disclosures and timing- Considerations on the consistent provision of income statement, balance sheet and cash flow tables in the quarterly release. Considerations were also intended for the positioning and prominence of GAAP and non-GAAP figures, GAAP reconciliation, the consistent placement of topics, and clear communication of any changes to accounting methods or key assumptions. This requirement would fulfill the objective of an earnings release being as a consistent, reliable communication which all investors can easily comprehend.
- Continued need for improvements in the management discussion and analysis (MD&A) and other public company financial disclosures- Enhancement in the quality of disclosures in MD&A rather than providing a mere recitation of the financials.

These international best practices may be constantly reviewed and necessary amendments may also be recommended by our regulators to meet the needs of investors.

and regulations are only a means but it is the responsibility of the organizations to abide by such regulations and provide meaningful disclosures to investors. We should constantly be updated on the International best practices and be ready to adopt the best practices without delay.

**Conclusion**

Indian corporates have gained competitive advantages worldwide for their transparent reporting practices. Laws

---