



## Strengthening corporate reporting structure: Steps towards developed securities market: A review

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### Abstract

SEBI, as a securities market regulator, has been initiating various policies and programmes year after year, to provide enhanced investor protection and to promote regulation and development of securities market of India. These efforts which started with the inception of SEBI in 1992 have been consistently in place for now almost three decades. All these years, due to these efforts of SEBI, the Indian securities markets have experienced a transformation from a highly controlled merit based regulatory regime to a market oriented disclosure based regulatory regime.

One of the important aspects of securities market is its efficiency measured in terms of dissemination of information by all market participants for stock prices are affected by it.

Thus disclosure of various forms of information by various market players, in particular the companies that have or intend to raise funds from the public, is of utmost significance. The medium of such information dissemination can be annual reports of companies which have already raised money from public and Offer Document (Prospectus) for those intending to 'Go Public'. Every year, SEBI, in order to bring transparency in the securities market operation, has emphasized on developing a culture of "Full and Fair Disclosures". For this it has implemented various policies and programmes which have gone a long way in achieving the goal of transforming Indian Securities Market into a developed one.

Through this research article of academic interest, an effort is being made to track various significant initiatives taken by SEBI to promote a culture of continuous disclosure by the companies, with the aim of achieving enhanced investor protection and promotion and regulation of Indian Securities markets.

For this study, the last five years Annual Reports of SEBI has been made as the base. Reference has also been made to various research works compiled by others in this area. It has been observed from the study, that SEBI has been doing a commendable job in terms regulating the markets as Indian securities markets have earned international respect and confidence. The testimony of this, as per a World Bank's Report, India ranks 7<sup>th</sup> in 2014 for Investor Protection out of 189 economies which were part of the assessment. Whereas in 2012 it was at 49<sup>th</sup> rank and in 2013 it was 34<sup>th</sup>.

**Keywords:** SEBI, disclosures, investor protection, policies

### Introduction

A healthy and regulated capital market (primary and secondary) is essential for mobilising capital while maintaining the confidence of market participants, i.e., issuers, intermediaries and investors. For keeping pace with the changing economic environment and for addressing concerns of various market participants, especially issuers and the investors, market regulations have been changed from time to time. These policy reforms are intended to facilitate easy capital mobilisation by industry while ensuring adequate investor protection. SEBI has been taking up various measures to make the Indian capital market more efficient and vibrant.

In a journey of almost three decades now, which was started with the underlying objective of protecting the interest of investors and promoting the development and regulation of the Indian securities markets, SEBI (the market regulator) and the Indian securities markets have progressed from strength to strength with each passing year. Over the years, it has been bringing in various measures for betterment and advancement thus transforming the Indian capital markets from a highly controlled merit based regime to a market oriented disclosure based regulatory regime.

In all these years, SEBI has continuously tried to incorporate various global standards and international best practices within its regulatory framework. It has gone through various domestic and global crises and emerged stronger, resulting in enhanced efficiency, integrity and transparency in the Indian securities market. This has earned lot of respect and credibility for Indian Securities market in the international arena and is regarded as one of the most developed securities market globally.

During the period of last five years, SEBI has brought in number of reforms to enhance the disclosures by companies, both in terms of quantity and quality. These policy initiatives have promoted investor protection and have made Indian markets as favoured investment destination.

The importance of disclosures in corporate reporting lies in promoting corporate transparency thus enabling informed and efficient decision making by investors. That's why SEBI has been endeavouring consistently to create a culture amongst corporates and other market participants to promote disclosures of various types of information that may be useful for the stakeholders and thus increases the accountability of them.

For the purpose of listing down the major policy initiatives taken by SEBI to ensure enhanced disclosures by companies, SEBI's Annual Reports of last Five years have been taken from the SEBI website. After going through the policies and programmes initiated under Primary market and secondary market, the important ones related to promotion of enhanced disclosure requirements for the companies have been short listed and presented below.

**1. Introduction of system-driven disclosures (To eliminate the possibility of inadvertent violations by entities and reduction of compliance burden)**

SEBI has taken a major initiative for easing the compliance burden of disclosures to be made by individuals and companies under SEBI Regulations, 2011 and SEBI Regulations, 2015 with respect to acquisition/holding and disposal of shares.

Under this system the onus of disclosure has shifted from individuals/companies to the securities market infrastructure through integration among depositories, exchanges and registrar and transfer agents (RTAs). Initially, the system has been made operational parallel to disclosures by individual entities in respect of certain disclosures under SAST (Substantial Acquisition of Shares and Takeovers) and PIT (Prohibition of Insider Trading) regulations. Such a system would aid in eliminating the possibility of inadvertent violations by the entities and would help in providing information to investors on timely basis to take investment decisions and would thus lead to fairness in the markets.

**2. Streamlining the process of system-driven disclosures**

Based on the experience gained by implementing the system, the process has been further streamlined pursuant to which the depositories will provide transaction data of promoters/promoter group on a daily basis directly to the stock exchanges instead of routing it through RTAs (registrar and transfer agents) for dissemination of necessary disclosures.

**3. Strengthening the continuous disclosure requirements for listed entities**

It was observed that the level of disclosures varied amongst listed entities, which many a time resulted in such disclosures adhering to the letter but not to the spirit of the disclosure requirements thus leading to asymmetric information with different types of investors. To address these concerns, provide guidance and improve the compliance culture, continuous disclosure requirements were amended.

The regulatory requirements now divide the events that need to be disclosed by listed entities broadly into two categories - those that have to be necessarily disclosed without applying any test of materiality and those that should be disclosed if considered material by the listed entity. For providing guidance, the listing regulations now also include criteria for determining the materiality of the events/information. A listed entity is also required to frame a policy for the determination of the materiality, based on the criteria specified which has to be duly approved by its board of directors and publicly available

by way of disclosure on its Website. An indicative list of the information which may be disclosed when an event occurs has also been Specified.

To ensure timely disclosures while not overburdening listed entities, the regulations provide that such disclosures should be made as reasonably soon as possible but *within a timeframe of 24 hours of the occurrence of the event*. However, *disclosures of the outcome of board meetings have to be made within 30 minutes of the closure of such meetings*.

In order to provide continuity in information to investors and to meet the essence of continuous disclosure requirements, Listing Regulations now provide that material developments with reference to an event should continue to be disclosed till such time that the event is resolved/closed.

The disclosure requirements specify the details that need to be provided while disclosing various events. In case the entity does not disclose any specified details, it has to state the reasons for not doing so in the disclosure. In case the securities of the listed entity

are also listed abroad, parity in disclosures has to be followed and, accordingly, whatever is disclosed overseas has to be simultaneously disclosed to the Indian stock exchange(s).

The listed entity has to disclose on its website all events/information which are material and such information has to be hosted for a minimum period of five years or more as per its archival policy as disclosed on its website. The listed entity also has to disclose all events or information with respect to its subsidiaries which are material for the listed entity.

The listed entity has to provide specific and adequate replies to the queries of the stock exchange(s) with respect to rumours and may on its own initiative confirm or deny any reported information to the stock exchange(s).

**4. Introduction of general information document**

The concept of General Information Document (GID) has been implemented.

GID shall contain information which is of generic nature (Like issue and allotment procedure) and not specific to the issuer, thereby eliminating the repetition of common information in abridge prospectus. This is expected to bring down the size of the abridged prospectus and ultimately reduce the cost of printing.

**5. Rationalisation of the abridged prospectus (Improved readability)**

It was observed that the abridged prospectus had become voluminous thereby defeating the very purpose of having an abridged prospectus. With a view to addressing this issue, the disclosure requirements in the abridged prospectus have been rationalised in consultation with investor associations and market participants.

The revised requirements for the abridged prospectus have been specified by a circular dated October 30, 2015. The abridged prospectus has been reduced from 50-60 pages to just ten pages without compromising on important disclosures.

The disclosures in the abridged offer document include details of promoters, business model/overview, board of directors, objects of the issue, shareholding pattern,

financials on a standalone and consolidated basis for the last five years, important internal risk factors, summary of outstanding litigations, claims and regulatory actions and the track record of merchant bankers.

The revised abridged prospectus improves readability and contains relevant information for investors to take well informed investment decisions.

**6. Streamlining the process of issuance of observations on offer documents**

The process of issuance of observations on draft offer documents filed by merchant bankers for raising funds by the companies or for takeover of other companies was streamlined. The total time taken in the entire process has been reduced considerably. There were studies and articles published in the media by independent analysts on this subject.

The status of processing each offer document, clearly indicating the reasons for pendency and also whether these were pending with SEBI or with the merchant banker or other regulatory agency, was displayed on the SEBI website on a weekly basis. The responses were sent to merchant bankers in a time bound manner, that is, within 30 days. With a view to ensuring a higher level of transparency and accountability within SEBI, the website also mentions that in case any application has remained unattended, the applicant should not hesitate to approach the senior officials - Chief General Manager or the Executive Director of the Corporation Finance Department. Their e-mail IDs are also provided on the website.

While the process of issuance of observations has been expedited, *the level of disclosures had also been enhanced*. As pricing of an issue is an important factor for investors to make investment decisions merchant bankers were advised to make additional disclosures on risks associated with a specific pricing of the issue in pre-issue advertisements on price bands. Examples of some of the risk factors which need to be disclosed in this respect, their applicability depending on each issue are:

- The track record of merchant bankers in the past three years in terms of issues handled and issues closing below the issue price on the listing date.
- Higher price earnings ratio of the issuer as compared to the average ratio of the industry peer group.
- Negative weighted average return on net worth, negative book value, etc.
- Losses incurred by the Issuer Company and negative earnings per share (EPS).
- Average cost of acquisition of equity shares for promoters or other major shareholders if the issue price for public is higher.

These disclosures are required to be made prominently in the same font size as the price band in the advertisements and also on the website of the company and the stock exchanges.

This step by SEBI will help common investors assess specific risk factors attendant to the pricing of a public issue and take well informed investment decisions.

**7. Integrated reporting by listed entities**

SEBI has mandated submission of Business Responsibility Reports (BRRs) for top 500 listed entities. The key principles which are required to be reported by the entities pertain to areas such as environment, governance, stakeholder relationships, etc.

*For improving disclosure standards of non-financial information* further, SEBI in consultation with industry bodies and stock exchanges specified a framework for integrated reporting (IR) by listed entities. An Integrated Report shows a holistic picture of the combination, inter-relatedness and dependencies between the factors that affect an organization’s ability to create value over time.

The International Integrated Reporting Council (IIRC) has categorized the following six forms of capital to be disclosed to stakeholders to enable informed investment decision making:

- Financial capital
- Manufactured capital
- Intellectual capital
- Human capital
- Social and relationship capital
- Natural capital

The integrated reporting framework provides seven guiding principles that can help create a concise, comprehensive and clear report. The eight content elements provided in this framework are aspects that should be there in a thoroughly integrated report. Together, they provide information about past performance and the short, medium and long term outlook of the company and how it plans to achieve that outlook. These elements also ensure that integrated reports are consistent and comparable across peer organizations.

**Table 1**

<b>7 Guiding principles</b>	<b>8 Content elements</b>
Strategic focus and future orientation	Organizational overview and the external environment
Connectivity of information	Governance
Stakeholder relationships	Business model
Materiality	Risks and opportunities
Conciseness	Strategy and resource allocation
Reliability and completeness	Performance
Consistency and comparability	Outlook
	Basis of presentation

SEBI has clarified that integrated reporting may be adopted on a voluntary basis from financial year 2017-18 by the top 500 companies which are required to prepare BRRs. Information related to integrated reporting may be provided in the annual reports separately or by incorporating it in the Management Discussion & Analysis or by preparing a separate report (annual report prepared as per the IR framework).

As a green initiative, companies may host their integrated reports on their websites and provide appropriate reference to it in their annual reports. Further, to avoid duplication, cross-referencing to other reports prepared in accordance with

national/international requirements/ framework is also permitted. It is significant to point out that the concept of integrated reporting is being discussed at international forums and is yet to be implemented in many of the jurisdictions. The move is aimed at providing stakeholders relevant information that is useful for making investment decisions.

#### **8. Extension of the applicability of business responsibility reporting requirements**

SEBI had earlier mandated publishing of Business Responsibility Reports (BRRs) in the annual reports of the top 100 listed entities based on market capitalization. The key principles which are required to be reported by the listed entities include environmental, social and economic responsibilities, governance and stakeholders' relationships. The applicability of BRR requirements has now been extended to the top 500 listed entities based on market capitalization as on March 31 of every year.

#### **9. Transparency in listed companies' dividend distribution policies**

In order to bring in more transparency with respect to listed companies' dividend policies, a new Regulation 43A has been introduced in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. This requires the top 500 listed companies (by way of market capitalization) to formulate and disclose their dividend distribution policies in their annual reports and on their websites.

##### **The policy includes**

- a. The circumstances under which shareholders can or cannot expect a dividend;
- b. Financial parameters that will be considered while declaring a dividend;
- c. Internal and external factors that will be considered for declaring a dividend;
- d. Policy as to how the retained earnings will be utilized;
- e. Provisions with regard to various classes of shares.

In case a company proposes to declare a dividend on the basis of parameters which are not part of this policy or proposes to change its dividend distribution policy, it is required to disclose this along with the rationale behind such an action. This policy was formulated in order to provide investors with a better understanding of the dividend policies of listed companies to be able to take informed decisions.

#### **10. Effective utilisation of the funds raised through public issues**

Investigations into some of the past public issues revealed that the issue proceeds were utilised for objects other than those mentioned in the offer document, viz., inter-corporate deposits and diversions to other companies.

In order to avoid the mis-utilisation of issue proceeds and to ensure that the issuers use the issue proceeds only in bank deposits that are not market linked, the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 have been amended. As a result, the

net issue proceeds, pending utilisation, have to be deposited by the issuers only in scheduled commercial banks.

#### **11. Prompt dissemination (disclosure) of the Impact of audit qualifications**

SEBI has in place a mechanism to review the impact of the qualifications contained in audit reports. With the objective of ensuring that the impact of the auditor's qualifications is disseminated without any delay and to further streamline the process, the following revised procedures have been prescribed:

1. The listed entities will be required to disclose the cumulative impact of all the audit qualifications on relevant financial items in a separate form called the 'Statement on Impact of Audit Qualifications'. Such disclosure will be in a tabular form along with the annual audited financial results filed in terms of the Listing Regulations.
2. The management will have the right to give its views on the audit qualifications.
3. The existing requirement of adjustment in the books of accounts of the subsequent year will not be necessary.

The new mechanism has been made applicable from the financial year ended March 2016, as well as for earlier cases.

The detailed procedure for this has been prescribed in Schedule VIII read with Regulation 33 and Regulation 52 of the SEBI (Listing and Other Disclosure Requirements) Regulations, 2015 (Listing Regulations) and SEBI circular dated November 30, 2015.

In consultations with SEBI's advisory committees, ICAI, stock exchanges and industry bodies, it has been decided to streamline the existing process as:

1. To make the listed entities disseminate the cumulative impact of all the audit qualifications in a separate format simultaneously while submitting their annual audited financial results to the stock exchanges. This will ensure that the information is available to investors without delay enabling them to take well informed investment decisions;
2. To dispense with the existing requirement of filing Form A or Form B for the audit report with unmodified or modified opinions respectively; and
3. To dispense with the existing requirement of making adjustments in the book of accounts of the subsequent year.

This was issued vide circular dated May 27, 2016.

#### **12. Disclosure of encumbrance on the shareholding of the promoter(s)**

SEBI has issued guidelines for the disclosure of 'reasons for encumbrance' on the shareholding of the promoters. For example, the reason may be for the purpose of collateral for the loans taken by the company, personal borrowing and a third party pledge. Henceforth, the 'name of the entity in whose favour shares were encumbered' will also contain the disclosure of the names of both the lender and the trustee who may hold the shares directly or on behalf of the lender.

### 13. Empowerment of stock exchanges for effective regulation of listed entities

In order to empower the stock exchanges for effective regulations of listed entities, amendments have been notified to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations) to enable actions such as imposition of fines and suspension of trading by stock exchanges for contravention of ICDR Regulations. This will be much more important in case of minor violations where current actions by SEBI such as prohibiting access to the market and adjudication/quasi-judicial action may be time and effort-consuming and not proportionate to the seriousness of the violation.

### 14. Monitoring of compliance by listed entities

SEBI has further strengthened its monitoring of compliance by listed entities. New listing regulations with better enforceability have been notified. As the number of companies listed on the stock exchanges is very large in India, the focus has remained on the introduction of a compliance culture among them.

SEBI envisaged and has implemented four levels of monitoring for listed entities by way of regulations and guidelines.

At the first level, company secretaries and the respective boards of directors of the listed entities will monitor the compliance of various regulatory requirements. Compliance reports on corporate governance and the report of an independent company secretary on compliance related issues are now required to be placed before the boards of listed entities. The boards are required to review the compliance reports as well as corrective steps taken in case of any non-compliance.

At the second level, an independent practising company secretary will review compliance and will certify the same as required under the provisions of the Companies Act, 2013. The certification in this regard is published in the annual report of the company which, inter-alia, includes the observations of the practicing company secretary. As mentioned earlier, SEBI has made it mandatory that such reports (along with the corrective steps taken) should be placed before their boards.

At the third level, the stock exchanges will monitor compliance or regulatory requirements of listed companies. Based on their monitoring they may levy fines, penalties, freeze the promoters' holdings in the company or suspend trading in the securities of the company depending on the level of non-compliance.

At the fourth level, SEBI will have overall regulatory oversight on the compliance standards of the corporate sector through various reports received from the stock exchanges.

SEBI repealed as many as 128 circulars pertaining to listing issued over the years and the contents of these circulars have been incorporated in the newly notified Listing Regulations. SEBI also issued 11 circulars under the same regulations.

With these circulars, SEBI has *enhanced disclosure requirements for listed entities* and helped the stock exchanges in monitoring compliance by the listed entities through various filings made by them.

### 15. Amendments to SEBI (Issue of Capital and disclosure requirements) Regulations, 2009 relating to preferential issue

With a view to *enhance transparency*, ensure adequate audit trail and apply lock-in for the shares allotted in preferential issues, the following amendments were carried out to SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009:

- a. Preferential issue shall be subscribed only through the allottee's own bank account. Further, the issuing company shall disclose the natural persons who are the ultimate beneficial owner of allotted shares and/or who ultimately control the allottee, subject to the condition that if in the ownership chain there is any listed company, mutual fund, bank or insurance company, no further disclosure will be necessary.
- b. Allotments in preferential issues shall only be made in dematerialized form.
- c. Shares allotted in the preferential issue shall not be transferred till trading approval is granted for such shares by the stock exchanges. Further, the lock-in period shall commence on the date of such trading approval.

### 16. Revised illustrative format of Statement of Assets and Liabilities in SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

The illustrative format of Statement of Assets and Liabilities in offer document which is provided under Regulation - (2)(IX)(B)(9)(f) of Part-A of Schedule VIII of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 was updated and brought in line with the revised Schedule VI of the Companies Act, 1956 and Schedule III of the newly enacted Companies Act, 2013.

### Conclusion

From the above stated reforms initiated by SEBI, over a period of five year (period of study 2012-13 to 2016-17), it is clear that the emphasis has been to develop a culture of transparency and self-compliance by the market participants. This has enhanced the efficiency of the Indian capital market. In all these years, the overarching goal of SEBI has been protection of interest of the investor community, regulating and promoting development of Indian securities market.

The initiatives like continuous disclosures and system driven disclosures would go a long way in putting Indian securities market in the global league. There has been adequate attention towards strengthening the monitoring mechanism also in terms of empowering stock exchanges and also itself for ensuring better compliance by the companies. Bringing in important amendments in laws governing issue of capital and disclosure requirements to enhance the quality and quantity of information disseminated by the companies to bring in more transparency in the market thus increasing its efficiency.

As already stated, in terms of investor's protection, already Indian Capital market appears in top 10 out of 189 economies, involved in assessment. It's a matter of great pride for us as Indians that today Indian securities market is considered as one of the best regulated markets in the world. This has been possible just because of continuous efforts of SEBI through improved regulations in the light of dynamic economic

conditions. As mentioned earlier, the journey which SEBI started in 1992, is almost three decades old now. Over all these years, SEBI has evolved learning and adopting the best international practices of securities market regulation and has contributed immensely in the economic growth of our country. To conclude, I would say that given the commitment level SEBI has, its strength and legacy, one can say with confidence that SEBI seems all geared up to face challenges of the dynamic market place, to evolve further with the times and take Indian Capital Markets to newer and greater heights in forthcoming years.

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