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Assistance to Securities and Exchange
Board of India - A Survey on
Corporate Disclosure Practices

Financial Institutions Reforms and
Expansion (FIRE) Project

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August 13, 1998

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Dear Mr Gahrotra

Sub Corporate Disclosure Practices

As part of its technical assistance to the Securities and Exchange Board of India (SEBI), Price Waterhouse LLP/FIRE Project has commissioned a study on the corporate disclosure practices by The Institute of Chartered Financial Analysts of India (ICFAI). A survey of retail investors, stock brokers, opinion makers, FIIs and other institutional investors was done by ICFAI. The study also focused on obtaining necessary information from stock exchanges. A questionnaire was administered to about 450 investors across seven cities. In addition, case studies were conducted of six Indian companies of varying standards of disclosure to understand the relationship between the quality of disclosure and market capitalisation.

This study was conducted under the supervision of Mr Michael Sommer, Securities Attorney with over 14 years of experience in the US Securities Markets and a PW LLP/FIRE Project consultant. Mr Sommer was assisted by Mr R N K Prasad, Senior Market Specialist and Ms Nitya Subramaniam, an intern with FIRE Project.

PURPOSE OF THE ASSISTANCE

The Indian capital markets suffer from a lack of information because many companies do not provide information on an ongoing basis. Further, the market is harmed because existing disclosure requirements do not provide for the wide dissemination of information. Finally, the ongoing reporting that is required by existing laws and regulations falls short of international standards for corporate disclosure.

A market that is fair and transparent, where share prices are based on accurate corporate and financial information, requires continuous disclosure by companies. The improvement of ongoing disclosure is a priority as the Indian capital market moves forward.

CONTENTS OF THE REPORT



The report covers the findings of the survey related to opinion of various classes of users, a comparison with the existing practices and the gap between the two. The results of the case studies are also included in the report. Finally, the report includes recommendations made by the FIRE Project for improved disclosures which are broadly

- Including general and certain types of additional information in the annual report,
- Strengthening the enforcement mechanism to ensure compliance with disclosure norms and,
- Creation of a disclosure department within SEBI and centralised information depository at two levels - one within SEBI and the other at the stock exchange level

NEXT STEPS

We believe that SEBI will benefit by the aforesaid study commissioned by the FIRE Project. In order to effectively utilise the findings of this study and improve the corporate disclosure practices we believe, SEBI should take the following steps

- I Study the existing processes in the preparation and filing of reports and cost of compliance with the existing disclosure norms,
- II Make a comparative study of international practices and the Indian norms and if found necessary bridge the gaps,
- III Set up a centralised information depository and disclosure department on the lines of the FIRE Project recommendations as per this report for effective collection, analysis and dissemination of information
- IV Conduct a study on the process involved in the preparation and filing of statutory reports

Upon reading the report should you have any questions, please call at Tel Nos 497 3216/3238, 494 6630/494 8718

Sincerely yours,

W DENNIS GRUBB
PRINCIPAL CONSULTANT CAPITAL MARKETS

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I EXECUTIVE SUMMARY

Timely disclosure of accurate information and dissemination of material information to the market are the salient features of a fair and transparent securities market. Investor confidence in the market is derived from availability of reliable information about issuers on an ongoing basis.

The growth of capital market in India is accompanied by the spread of equity ownership to a large part of the country. Investors – retail as well as institutional – with varying needs, preferences and amount of surplus resources available have increasingly participated in the deepening and widening of capital market in India. Despite these developments, the issues of corporate information disclosure and its availability to investors have not been given sufficient attention in India. Non-availability of adequate and qualitative corporate information has consequences on the efficiency of a market's allocation of resources and investor confidence.

Given the fact that investor confidence in the Indian securities market is at its lowest ever, there is a dire need for

- improvement in standards of disclosure
- for one or more public depositories to be set up for collection, monitoring and review of issuer reports and other information
- for an enforcement mechanism which enables swift corrective action to be taken by a central regulatory authority.

As part of its assistance to SEBI and with the objectives of

- identifying gaps in the information required by the end users and existing disclosure norms, and
- determining whether a relationship exists between the level of disclosures by companies and their market capitalization, the FIRE Project has commissioned a survey by the Institute of Chartered Financial Analysts of India (ICFAI) to
 - * to review the present disclosure practices of corporate firms in India and to identify the inadequacies in the quantity and quality of corporate information available at present
 - * to analyze the corporate information requirements of investors
 - * to analyze the frequency and medium of disclosures
 - * to suggest measures to improve the corporate disclosure practices in India

This report reviews the study findings and the FIRE Project recommendations to SEBI to improve the existing disclosure norms and to set up a centralized information depository at SEBI and in stock exchanges for efficient information collection and dissemination.

A STUDY METHODOLOGY

A survey was conducted by ICFAI in association with FIRE Project on several disclosure related issues

The methodology employed was an independent survey of end users of information viz retail investors institutional investors - domestic and foreign stock brokers stock exchanges and opinion makers was conducted. The objective was to analyze and compare the results of the survey to the existing disclosure practices being followed by companies operating in India and to identify gaps in the same.

This survey was complemented by case studies on six Indian companies. These are classified as companies

- whose disclosure standards are higher either because
 - * the company has tapped international capital markets
 - * the company has voluntarily adopted international standards for disclosure and
- companies which are meeting the existing disclosure requirements under Indian laws and regulations

B SURVEY FINDINGS

The detailed analysis of the responses to the questionnaire along with the case study observations and recommendations is enclosed in Appendix I. The findings in brief are as below

1 Information Disclosure

The respondents of the survey found the following additional information as having a material influence on their investment decisions and hence desired disclosure of the same by issuers

(i) Disclosures in Annual Reports- Mandatory

- The annual report should include a historical background of the company and its business in order to improve the understanding of the financial statements
- Historical data for the last five years should be given to enable analyzing of trends and relationships to predict future earnings
- Profit and loss account should be reformatted to disclose gross profit
- The following additional disclosures should be made on convertibles warrants and stock options
 - * Fully diluted EPS as per the International Accounting Standard

- * Shareholding pattern post conversion
- * Due dates of conversion
- * Options exercised in the case of stock options
- The following details about imports and exports should be given
 - * Percentage of total sales/ purchases
 - * Countries of export/ import
 - * Currencies to which there is risk exposure
- Off balance sheet items Adequate disclosures should be made about the identity financial impact risks and obligations resulting from the following off balance sheet items
 - * Leased assets
 - * Contingent liabilities
 - * Financial instruments in the nature of off balance sheet items
- Management analysis of the financial statements using key ratios should be given Ratios such as Earnings Per Share (EPS) Return On Net Worth (RONW), Debt Equity Ratio (DER) and Current Ratio should be included It should also include comments on cash flow statement
- Share performance A graph of the share price movements during the reporting period against BSE or any other suitable index must be included It should also disclose volumes of trading
- The following details of investor complaints should be included
 - * Number of complaints received during the reporting period
 - * Number of complaints settled
 - * Number of complaints pending for more than 30 days
 - * Number of complaints received as a percentage of number of shareholders
 - * Nature of complaints

(ii) Disclosures in Annual Reports – Optional

- Forward looking information which would help users to forecast for themselves the company's financial future
- A risk management framework may be developed and disclosed covering major internal and external risks such as business risk financial risk interest rate risk and foreign exchange risk The framework can include both policy and performance parameters
- Information on high and low of share price during the reporting period

(iii) Disclosures in Quarterly and Other Reports

- Companies should mail these reports to the shareholders on a mandatory basis
- Rating on all fixed income securities issued by a company should be disclosed on a quarterly basis. Changes in ratings and rating agency should be disclosed on the occurrence of the event
- Quarterly reports should be audited and drawn up in the same format as the Annual Reports
- Notes to summary of results published on a quarterly basis should include explanations about significant deviations from performance during the previous period for which comparative figures are disclosed
- Penalties if any imposed by regulatory authorities for non-compliance or violation of norms should be disclosed on a quarterly basis

2 Information Dissemination

- The survey found wide disparity in the dissemination of information to different categories of investors – the FIIs and other Institutional Investors are perceived to be getting the best in terms of quality analysis and volume and the retail investors the least, often just an outdated Annual Report. The different categories of investors are therefore in unequal bargaining positions. This often forces the small investors to rely on market rumors, broker recommendations etc while making investment decisions
- No mechanism exists to ensure quick dissemination of price sensitive material information. With no provision for share ownership reporting by directors, officers etc to SEBI it was felt that insider trading is rampant
- The medium of disclosure in India where multiple agencies are involved fails to disseminate corporate information in an effective manner to all the investors on a real time basis. Though the print media and the magnetic media have grown in terms of size and coverage the dissemination mechanism is far from effective
- The survey revealed that most of the stock exchanges do not have the required infrastructure to review process and disseminate information based on filings made by issuers. The stock exchanges however agree that they must take the responsibility for dissemination of information to investors
- The survey also revealed that the listing fee collected by the exchanges is adequate to cover the costs of providing such service

3 Enforcement

- Lack of penal provisions for non-compliance is cited as one of the main reasons for poor information dissemination and poor quality of disclosures. The filings to be made by issuers as per the listing agreement are not enforceable by the stock exchanges. The only drastic step that the stock exchanges can take is delisting. However, this hurts the investors more than the issuers.
- No action can be taken by SEBI on issuers who have vanished without a trace after raising funds through public issues.

C FIRE PROJECT RECOMMENDATIONS

Based on the detailed survey reports, its observation on the existing disclosure practices and the additional disclosures suggested by the Bhave Committee, the FIRE Project makes the following recommendations:

1 Improvement In Information Dissemination

At present, SEBI does not regulate or require ongoing disclosures by issuers. Issuers are required to comply with financial reporting provisions as per the Companies Act, 1956. In addition, SEBI directs stock exchanges from time to time to amend listing agreement with the issuers to incorporate clauses for additional disclosures to be made. The stock exchanges, however, lack the proper mechanism to enforce compliance with listing agreement requirements. In order to improve the existing information collection and dissemination mechanism, FIRE Project recommends:

- that continuing disclosures should be brought under the exclusive purview of SEBI
- setting up of Information Depositories at two levels
 - * In SEBI at the national level
 - * In stock exchanges at the regional level

Issuers should be required to file reports with SEBI and the stock exchanges where the shares are listed. These should be reviewed, monitored, checked for accuracy and consistency by trained professionals to be employed/outsourced by them. SEBI and stock exchanges should be responsible for prompt dissemination of material/price sensitive information received by them.

- SEBI should issue guidelines to all stock exchanges for setting up of a public reference facility on a mandatory basis. SEBI and the stock exchanges should have a home page on the internet to which all filings can be posted.
- share ownership reporting and reporting of movement of shareholding by directors and officers who have substantial managerial powers of a company should be made mandatory. This will allow the market to track insider trading and thus

prevent the practice. Further, auditors should be precluded from holding shares of the companies whose accounts are audited by them. All listed companies are urged to adopt a code of conduct for prevention of insider trading which should cover the following salient points:

- * Persons to whom the rules under the code of conduct would be applicable
 - * Definitions of Insider unpublished price sensitive information and dealing in shares
 - * Prohibition on dealing, communicating or counseling
 - * Procedures for dealing in the shares of the company by employees and senior management
 - * Prohibition for dealing in shares before and after the end of a quarter and before and after a Board meeting
 - * Report to Board of Directors of the Company and SEBI
 - * Penalty for violation
- that SEBI undertake a detailed analysis of the existing norms, procedures and processes and information flows and cost of compliance with such practices to establish cost-benefit analysis
 - that SEBI should take note of the requirements of the investors as evidenced by the survey findings and implement such findings as may be found fit

2 Improvements in Enforcement Mechanism

FIRE Project recommends that SEBI should bring in such measures to regulate the securities market as would enable it to emerge as a single, highly visible authority which can function independently with a strong statutory backing.

- SEBI should take up studies to find out the present status and whereabouts of the projects and promoters of around 4000 public issues made during April 1992 and March 1996, identify the fly-by-night operators from among them and take exemplary punitive action against them. Punishment should include impounding of issue proceeds from the promoters and refunding the same to the investors.
- Following alternatives can be considered to weed out the numerous illiquid scrips listed on the stock exchanges:
 - * Permit promoters to buy back the shares
 - * Before delisting the scrips, make it mandatory for the promoters and merchant bankers to make an open offer to all the investors to purchase the shares at a determined price.
- SEBI should tighten the norms for new issues. Companies with no track record should be allowed to list only at the OTCEI.

- that SEBI should periodically publish/widely disseminate information to investors on details of non-compliance by listed companies. Such publicity would act as a strong deterrent to violation of norms by issuers
- that SEBI should draw up a penalty structure for different categories of non-compliance and enforce the same quickly and meticulously. For this to be effective SEBI should be armed with adequate powers to initiate criminal action and to have a mechanism for quick redressal of investor grievances. This may be enabled if SEBI is vested with the powers of a civil court under Code of Civil Procedures
- management and auditors should be held accountable in order to prevent companies from giving misleading information

II. BACKGROUND

A market that is fair and transparent where share prices are based on accurate corporate and financial information requires continuous disclosure by companies. Full and fair disclosure is essential for the market to serve investors and allow fair prices to be established.

The lack of available information and the inadequate quality of existing information about public companies has serious consequences for the Indian capital market. Currently, there is a lack of transparency in the capital market. This is detrimental to all investors and ultimately to the companies themselves.

Every market participant, whether an investor or a government regulator, recognizes that the filing of an offering document or prospectus, which is accurate and complete, is essential for the functioning of a fair and transparent securities market. This is because, when the company makes a distribution of shares, the market needs such information about an issuer and its business and financial condition. However, in India, this is where the emphasis on disclosure comes to an abrupt halt.

It is the concept of period reporting, which should be given equal importance by SEBI, the issuers, professional market participants and investors. Investors buying or selling shares of an existing company in the secondary market have the exact same need for complete information as investors do in an initial public offering. It is the periodic disclosure and ongoing reporting requirements that are the source of this essential information necessary for operating in the secondary capital markets. In the existing Indian capital market, this continuous reporting by issuers is lacking.

The stock exchanges do not have the clout necessary to impose and enforce comprehensive ongoing disclosure obligations by themselves. The listing agreement with the stock exchange usually provides for the filing of annual and quarterly reports with the exchange. However, many companies are not in compliance with such reporting requirements and get away with the same.

Disclosure should provide sufficient details to allow investors to utilize that information meaningfully. In addition to timely and specific disclosure obligations, issuers should disclose any other material information necessary to make the given information clear or not misleading. Both current and historic information are necessary.

The Indian capital markets suffer from a lack of information because

- many companies do not provide information on an ongoing basis
- existing disclosure requirements do not provide for the wide dissemination of information and

- the ongoing reporting required by existing laws and regulations falls short of international standards for corporate disclosure

The improvement of ongoing disclosure is a key element of the anti fraud protection mechanism and is a priority as the Indian capital market moves forward

At the present time SEBI does not regulate or require ongoing disclosure by issuers. In fact in the present regulatory framework no authority seems to have taken the responsibility to ensure continuous disclosure by issuers. Investor confidence in the securities markets whether investors are individual institutional or professional market participants depends on the availability of information.

Well balanced disclosure standards can be established by a central securities regulator. Investor confidence can be further enhanced if this central regulator has the power to take swift corrective action against non abiding issuers.

Timely and continuous disclosure of financial information by issuers is a key element of the regulatory process in mature capital markets. The timely disclosure of information allows the market to fulfill its obligations to provide a forum for fair trading where the price of securities may be established. Without this information the price determination may not be accurate. Indeed the integrity of the market requires information about all issuers.

The scope of regulation over disclosure standards and requirements should be extended to be consistent with standards of international practice. Thus continuous disclosure by issuers ownership reporting and ability of the regulatory authority to review the required filings can improve standards of issuer responsibility and corporate governance.

It is advisable to provide one or more public depositories for issuer reports and other information. The regulator and the exchanges both can and should serve these functions. Indeed in the US the largest source of information about public companies continues to be the public reference facility of the SEC. In developed markets information is also collected and analyzed and disseminated by a number of companies that specialize in such information services.

Legal liability for material misstatements withholding of information and the failure to comply with the established disclosure requirements is another necessary area for development. Anti fraud provisions should be adopted and civil liabilities set forth.

III EXISTING DISCLOSURE PRACTICES – OBSERVATIONS

A GENERAL CORPORATE INFORMATION

Investors, specially prospective investors, require many general details about a company. At present, all this information is not readily available to investors. Some of this information is available to subscribers of special publications like The Official Directory of the Bombay Stock Exchange, Bombay Stock Exchange Review, etc. It is natural to look forward for this information in the Annual Report of a company as this report serves as a primary medium for disclosure of historical developments of a company.

Corporate firms in India follow provisions of the Companies Act, 1956, in the preparation of Balance Sheet, and the Profit and Loss Account. The law requires a company to provide Balance Sheet and Profit and Loss account, additional break-up, details of entries in Balance Sheet and Profit and Loss account, report by directors and report by auditors to shareholders of a company.

There is no legal requirement on the part of a corporate firm to provide general information to either shareholders or outside parties. While a few companies do provide such details, most Indian companies limit their Annual Report to

- a brief Directors' Report to shareholders,
- Balance Sheet and Profit and Loss Account with Schedules described under Schedule VI,
- Auditors' Report and
- Balance Sheet and Profit and Loss Account of the subsidiary companies.

In contrast, corporations in developed markets provide volumes of information about themselves and their products. In fact, in Annual Reports of some developed countries, the financial statement figures are presented in the middle part of the report and nearly 50 percent of the report is devoted for general information about a company.

The issue of providing general information on corporations has not been given sufficient thought in the Indian context.

In a large country like India, location of plants for manufacture of products like cement, fertilizer, sugar, etc., of a firm is an important factor in the determination of earning capacity of a corporate firm. Thus, corporate firms should disclose information on geographical location of plants, products manufactured in each of the plants and corresponding capacity details.

Only a few companies are able to pass on all the cost increases to the consumers as and when the input price changes. The change in the price of inputs affects their

earnings. Thus, trends in the prices of raw materials and other inputs have a significant influence on the performance of corporate firms. Hence there is a need to provide such information to investors through annual reports.

The Companies Act, and SEBI regulations do not require companies to disclose any information related to shareholding to the investors of a corporate firm. Corporates are, however, required to furnish the complete details of shareholders and debenture holders to the Registrar of Companies (RoC), every year. Investors have to rely on a variety of data base services to find the share holding pattern and also the volume and price statistics of securities. Hence, there is a need to incorporate the same in the Annual Reports besides continuing the existing practice of providing to stock exchanges.

It is generally believed that companies in which financial institutions and foreign institutional investors have a large stake, adhere to professional management standards of corporate governance and adopt good corporate ethics in their conduct.

Information on organizational structure, management team and details of employees will give insights into the extent of professionalism of a corporate firm. If powers are concentrated in a few hands without proper external monitoring, the scope for pursuing policies which further the self interest of decision makers tends to be high. In the absence of wider participation in the decision making process, the efficiency level will come down. At present, there are only a few public sector companies (for example HMT) which give such detailed human resources accounting in their Annual Reports.

Continuous disclosure provides a fair and level playing field for all investors. To find the exact information requirements of shareholders, a survey was conducted. The details are given in the next section.

The implementation of these recommendations should be followed up with the assistance of members of the FIRE Project. The Bhave Committee report touched on other improvements in disclosure. This group could also be used as an ongoing committee to make concrete recommendations to the Ministry of Finance and SEBI for improvements to disclosure norms.

IV STUDY METHODOLOGY

A survey was conducted by the Institute of Chartered Financial Analysts of India (ICFAI) in association with Price Waterhouse on several disclosure related issues. The study was concerned with examining the feasibility of improving existing norms of issuer ongoing disclosure and dissemination of information and possibly establishment of a centralized information depository for easy and accurate collection and dissemination of information about corporations.

The objectives of the survey were:

- To identify gaps in the existing disclosure practices and the needs of the end users if any and
- To establish a relationship between level of disclosures adopted by the companies and their market capitalization.

An independent survey of end users of information viz Institutional Investors – domestic and foreign, Stock Exchanges, Stock Brokers, Opinion Makers and Retail Investors was conducted. The objective was to analyze and compare the results of the survey to the existing disclosure practices being followed by companies operating in India. The purpose is to identify gaps in the existing disclosure practices and the needs of the end users.

Case studies were conducted on Indian companies

- whose disclosure standards are higher either because
 - * the company has tapped international capital markets
 - * the company has voluntarily adopted international standards for disclosure and
- companies which are meeting the existing disclosure requirements under Indian laws and regulations.

A STRUCTURE OF QUESTIONNAIRES

Separate questionnaires were designed for each category of end users. However, the category of opinion makers were administered the same questionnaire meant for institutional investors. While most of the questions were common, additional questions were included for stock exchanges and stock brokers to elicit information on the infrastructure available with them for receipt, processing, storage, retrieval and dissemination of information. The questionnaire for retail investors was brief and less technical.

The questions in the survey were organized under the following categories:

1. General
2. One Time Disclosure

- 3 Continuing Disclosures on
 - Operations
 - Finance
 - Projections
 - Off Balance Sheet Items
 - Risks
 - Bankers
 - Rating
 - Legal Compliance
 - Investor Protection
 - Properties
 - Personnel & HR
 - Corporate Governance
 - Views of Retail Investors

- 4 Feasibility of Stock Exchanges playing a lead role in dissemination of information to investors

B ADMINISTRATION OF QUESTIONNAIRES

The questionnaires were administered by researchers selected by ICFAI Business School from among its students. The selection was based on their knowledge of capital markets, communication skills, etc. In the Institutional Investor category, the questionnaires were administered to persons in top management cadre namely CEO/MD/Fund Manager/ Head of Research/ Head of Investments. In the Stock Exchange category, the questionnaires were administered to the Executive Director of the Exchange. In the Stock Broker category, the respondents were either partners or managers of the Brokerage Firm.

The Opinion Makers included business editors of financial newspapers and business magazines, analysts of institutional investors, financial analysts, financial and management consultants, advocates and chartered accountants. The Retail Investors were selected from among high net worth individuals, based on references from Stock Exchanges and Stock Brokers.

Respondents located in major cities (four metros and Ahmedabad, Bangalore, Pune and Hyderabad) were personally interviewed. Respondents located outside these cities (Stock Exchange, Stock Brokers and Opinion Makers category only) were mailed the questionnaires.

C METHOD OF ANALYSIS

The responses were analyzed category-wise. The divergence in views of investors on the same questions among different categories was mapped. The differences found have

been highlighted Where all categories have held the same view a consolidated picture is given

Let us now study the findings of the survey Issues have been stated separately and the investor s viewpoint listed alongwith

V FINDINGS OF THE SURVEY

SECTION I SURVEY FINDINGS

The respondent's views on various issues were divergent on the attributes of information which are relevant for investment decisions. Many of them expressed that all attributes were important and were complementary.

Annual reports and Offer documents were considered to be the most important source of information. The Retail Investors also ranked research reports as important.

The information required by most respondents to make informed investment decisions were (in order of priority)

- Economic, Industry and Company Analysis
- Analysis of Financial Statements
- Views of largest stakeholders other than promoters

A GENERAL INFORMATION

The questions under the General Section were intended to get an idea of the

- end user's perceptions about the attributes of information
- important sources of information
- additional information required to make informed investment decisions
- present state of the capital market
- the disclosure practices of companies
- the role being played by the regulatory authorities and stock exchanges
- expectations of regulatory authorities and stock exchanges

On the ease of availability of information about any company 78% of the respondents said it was not easy to collect information about a company. The Retail Investors were of the view that no information other than the annual report was accessible.

On creation of a centralized information depository. The respondents were near unanimous in voting for a centralized information depository.

On whether the stock Exchanges should take a greater role in disseminating information. 94% of the investors would like it to be so. However, the Institutional Investors felt that if there is a centralized information depository, the Stock Exchanges are not necessarily required to play a greater role.

On whether some professional information providers should collect the required information from companies on a continuous basis collate and furnish the same. 83% of the respondents were in favor of professional information providers to collect this information from companies and furnish the same to the end users. Almost those who were not in favor doubted the reliability of such information.

On whether the existing disclosure norms are adequate Majority of the respondents felt that the disclosure norms are inadequate Transparency on the part of issuers and monitoring on the part of regulatory authorities is also lacking

On whether companies adhere to existing disclosure norms It was felt that the compliance or adherence is in letter but not in spirit For example the annual report may be in the required form with the required information but it may still not give a true and fair picture The reasons for companies not adhering to disclosure norms were attributed to the following

- Lack of regulatory monitoring and oversight
- Lack of insistence by auditors
- Loopholes in the norms

On whether companies deliberately mislead investors Opinion was divided across categories 67% of respondents in all other categories felt so, while only 34% of the Institutional category of respondents felt so Institutional Investors may feel so because

- the investments of Institutional Investors are in 'A' category shares which are of companies with high market capitalization and better disclosure standards
- it is difficult to generalize and say that all companies do or do not mislead investors

On steps to be taken to prevent companies giving misleading information

- managers and auditors to be held accountable
- penal provisions
- criminal action

On correlation between the willingness to part with information and the performance of the company While the Institutional Investors felt that there was a positive correlation the Opinion Makers felt otherwise if the performance of the company is generally good it is easy to convey some bad news without attracting too much attention

On the time gap between the availability of information and its accessibility to investors Majority of the investors said that they had access to information 1-3 months after it is made available by the company

On the reliability and accuracy of information made available in the financial reports Stock Exchanges were considered the most reliable and accurate of information sources

B ONE TIME DISCLOSURE

On whether the objects of the offer disclosed in the prospectus were satisfactory 60% of the respondents were not satisfied with the objects of offer disclosed.

On whether additional disclosures should be made if the issue is to meet the working capital needs only. Majority of the investors were in favor of this.

On whether a bank appraisal should be insisted if the issue is for raising working capital. Investors preferred to have additional disclosure on

- (i) why the issuer is not using funds from the banks and
- (ii) detailed assessment of working capital requirement.

On whether the issuer company should long disclose its mission and long term strategy in its offer document. It was felt that this would serve only a limited purpose. It would be better if the company gave a brief on the core businesses of the company as that would serve the purpose of understanding if the company is headed in the right direction.

On whether the capital market is adequately monitored and supervised. While 50% of the Stock Exchanges feel it to be so, a majority of the respondents in all other categories think otherwise. Suggestions on what needs to be done to improve supervision of capital markets.

- Regulatory authority to tighten disclosure norms with strong penal provisions for non compliance
- Stringent norms for listing and delisting
- Professional management of stock exchanges
- Reduction in the number of companies listed on the Exchanges
- Improvement in infrastructure
- Auditors to give detailed qualifications to financial statements
- Management and auditors to be held accountable to both the regulatory authorities and shareholders while the regulatory authorities to be held accountable to the shareholders.

C CONTINUING DISCLOSURES

I Operations

Questions under this section were on whether the end users would like to have certain additional information on the company's operations exports imports technology expenditure on research and development etc. If this information were to be required, what should be its frequency of reporting and the source document for its presentation?

The respondents were strongly in favor of segmental reporting giving details of operations product/division-wise on a quarterly basis. They wanted the disclosure of details of exports and imports in the annual report. Changes in technology/ technical collaboration could be disclosed in either the annual report or on the occurrence of event. Considering that the amounts spent on R&D by Indian companies are insignificant with the exception of some industries like pharmaceuticals information on R&D expenditure was not required by the respondents.

2 Finance

Questions in this Section pertained to the quality of disclosures in financial statements and of accounting standards. disclosures in quarterly, half yearly and annual reports need for disclosure of financial ratios, dividend policy, information on convertibles and suggestions for improvement in financial reporting.

The respondents felt that most annual reports do not reflect a true and fair picture of the company and the current disclosure standards range from good to poor with majority of response under adequate.

On whether the information published in the half yearly reports, in the abridged form is adequate. If not, what additional disclosures are required? 69% of the respondents felt that the information in the half yearly report is not adequate. Most of the respondents wanted the half yearly reports to be audited and in the same format as the annual report.

On ranking the Indian Accounting Norms as compared to those of other developed countries. Respondents felt the Indian Accounting Standards to be good.

- Majority of respondents viewed changes in accounting policy by companies unfavorably but an equal number were of the opinion that if it is for improving the quality of reporting it would be acceptable.
- Respondents felt that in case of change in the depreciation policy, the company should disclose profits based on depreciation calculated as per the old method also. The current market value of the fixed assets should be disclosed to get a better idea of the asset base of the company. In case of change in the inventory valuation policy, the company should disclose profits based on inventory valuation as per old method also.
- Respondents were in favor of analysis of company's performance by its directors, specially the non-executive directors. As the directors met once a quarter, such analysis was desirable on a quarterly basis.

- Respondents wanted the companies to report select financial ratios on an annual basis. They felt that the calculation of such ratios should be standardized. EPS, RONW, D/E R and Current Ratio were the ratios considered most important.
- On whether the information provided by the company on convertibles/warrants etc. which results in dilution of equity is adequate. If not, what additional information is required? 65% of the Institutional Investors and Opinion Makers felt that the information is not adequate. Others were equally divided on the issue, perhaps because of their inadequate knowledge on the subject.

The following suggestions were made on additional disclosures to be made on convertibles:

- * Full disclosure on shareholding pattern, warrants due, strike price of warrants, options exercised in case of stock options and impact on EPS.
 - * Some respondents wanted disclosures on fully diluted EPS as per International Accounting Standard on EPS.
- Respondents wanted the specific details on 'other income' if it formed a significant part of Profit Before Tax. They favored such information to be published on a half yearly basis.
 - Other than Institutional Investors, respondents desired disclosure on measures of volatility of earnings like beta.
 - Disclosure of dividend policy was considered relevant by retail investors. Majority of the respondents were in favor of justification being provided for retention of a portion or all of distributable profits.
 - On whether significant gaps were found between International Accounting Standards and Indian Accounting Standards. As the familiarity with International Accounting Standards is limited, the percentage of 'no' and 'no response' is high. Of those who agreed that there are significant gaps between International and Indian Accounting Standards, 80% felt that the investment decisions could be improved if accounts were presented as per the International Accounting Standards.
 - The following suggestions were made for improvement in financial reporting:
 - * Cash flow statement to be provided on a mandatory basis.
 - * Consolidation of accounts of subsidiaries with the parent company accounts.
 - * Disclosure of contingent liabilities and provision made for the same.
 - Reporting should conform with International Accounting Standards.
 - Segment Reporting.

- The respondents unanimously agreed that management and auditors should be held liable for misleading financial statements or for negligence in preparing the financial statements

3 Projections

This Section deals with issues regarding the importance of furnishing projections in the Offer documents and other reports

FIRE Project notes that the Malgum Committee (on disclosure requirements in Offer Document) has placed a number of conditions on disclosure of projections in Offer Document as they can be a source of misinformation and are often grossly optimistic. Example of a condition being projections should not be for more than two years and should be based on an appraisal made by a Financial Institution or a Bank or a Lead Manager

Feedback on the following issues was obtained in the survey

- On whether projections should be a part of the Annual Report and be presented in a prescribed format 68% of the respondents feel that projections should form a part of the Annual Report/ Offer Document. They feel that management should be held accountable for their projections, to the extent deviations are due to internal factors

Majority of the respondents are in favor of projections being made using both expected values optimistic and pessimistic values. Respondents favor projections for three years in the Offer document and for one year in the Annual Report

4 Off Balance Sheet Items

Issues addressed in this section are for need for disclosures regarding contingent liabilities, leased assets hedging instruments, use of derivative instruments and attendant risks and accounting for forward foreign exchange contracts

- Majority of the respondents feel that companies do not disclose contingent liabilities in a proper manner nor do they make adequate provisions for them
- Most of the respondents were in favor of proper disclosure of leased assets and of hedging instruments
- Majority of the respondents were in favor of forward foreign exchange contracts on balance sheet dates and transfer of gain/loss arising therefrom to profit and loss account

5 Risks

Issues considered here were on the nature of risks to be disclosed, risk analysis framework and feasibility of developing a composite risk index.

- On whether a risk management framework should be undertaken by a company and disclosed in the Annual Report. 80% of the respondents were of the view that the companies should undertake a risk management framework and disclose the same in the Annual Report. It should mainly include the business risk and the financial risk. Opinion on the standardization of the framework was mixed.
- 59% of the respondents were in favor of the company providing forward looking information on expectations about performance vis-a-vis international competitors.
- On whether it is feasible to develop a composite risk index for a company. 67% of the stock exchanges felt that it is feasible whereas majority of the respondents in other categories were of the opinion that it is not feasible.

6 Bankers

- While 70% of the respondents were in favor of disclosing the names of bankers, a substantial 28% felt that the information was not relevant.

7 Rating

Issues related to importance of rating for investment decisions, instruments for which rating is desired, disclosure of existing ratings and changes in ratings from all rating agencies.

- Majority of the Institutional Investors felt that rating is not very important as it is not a lead indicator most of the time. Majority felt that rating should be for fixed income securities and if feasible, for the management and the entire company.
- The respondents unanimously felt that companies should obtain ratings from one agency consistently and should not switch rating agencies.
- The companies should report on a quarterly basis ratings obtained on all its fixed income securities.
- The respondents felt that the rating agency should publish information on all ratings on a monthly basis.
- A number of respondents also doubted the credibility of the rating agencies.

8 Legal Compliance and Investor Protection

The issues in this section deal with reporting related to compliance need for a compliance officer and compliance audit and disclosures relating to investor complaints

- Most of the respondents wanted companies to furnish information to investors regarding non-compliance with various statutory norms and regulations
- A majority of respondents wanted information on charges against the company by Government officials and charges against promoters/top management to be communicated to the investors. Some of them reasoned that companies will not furnish the same. Instead they wanted the regulatory authority to periodically disseminate such information
- 89% of the respondents were in favor of details of investor complaints to be published. A majority were in favor of the details to be furnished on a mandatory basis
- The idea of a company engaging the services of a Compliance Officer was welcomed by most of the respondents and some felt that the Company Secretary himself can play the role
- The respondents felt that the official spokesperson should have the authority to give the required information about the company and he should be held accountable for the statements made by him. The retail investors felt that all the market players namely institutional investors, FIIs, Brokers and Retail Investors should get the same amount of information from the same source
- As regards Compliance Audit as is done in the developed markets, it was felt that no useful purpose would be served and it would be one more regulation formality to be complied with

9 Properties

Questions under this section were on the desirability of disclosing information about the immovable properties of the Company

- 80% of the respondents wanted information on immovable property to be disclosed. Market value and strategic importance were the essential items, details of which were sought to be disclosed

10 Personnel & HR

Questions under this section related to desirability of information on Board of Directors and top management relating to their compensation, experience etc.

- 85% of the respondents favored disclosure on details about Board of Directors/ Top Management. Information to be furnished should include qualifications, past experience, track record in previous employment, salary and nature of employment.
- Majority of the respondents felt that disclosures on non-cash compensation to management are not adequate.
- As regards information being provided in the Director's Report on employees drawing remuneration of not less than Rs. 25,000/-, most of the respondents felt that such information is not very relevant and should be provided only for key employees.

11 Corporate Governance

Questions under this section related to investor preferences for types of organization and mechanism to prevent insider trading.

- Institutional Investors did not distinguish between family owned businesses and professional organizations. A minority of the retail investors preferred family owned businesses like Iatas, Birlas and Ambanis.
- Many of the investors felt that it is very difficult to prevent insider trading. A few suggestions which came up to curb insider trading were:
 - Filing of periodic ownership reports by key employees
 - Companies to develop in-house protocol to prevent insider trading

12 Views of Retail Investors

The retail investors are of the strong view that the market is at the mercy of the Institutional Investors and loaded against the small investors. They feel that they have no access to corporate information. There is an urgent need for SEBI to put in place a redressal system for investor grievances which is expeditious, fair and infuses confidence in regulatory authority.

D FEASIBILITY OF STOCK EXCHANGES PLAYING THE LEAD ROLE IN DISSEMINATION OF INFORMATION TO INVESTORS

The Stock Exchanges agree that they should play the lead role and should provide a Public Reference Facility. Most of them however presently lack the required infrastructure in terms of systems, processes and skilled personnel to collect, process, store, retrieve and disseminate information on issuers. While the Exchanges have not given the cost of providing such facility, all of them have said that the listing fees is adequate to cover their costs.

SECTION II OBSERVATIONS FROM CASE STUDIES

A summary of findings of the case studies is given below.

- Companies display the tendency to shout good news and suppress bad news. When performance is good, detailed commentaries form part of the Director's report, comparing performance with previous years, including graphic presentations of the positive trend. Such disclosures are reduced to a minimum when performance is adversely affected.
- Some companies, particularly the larger ones, are already providing information that substantially meets the requirements of various end users. Majority of the companies however provide the bare minimum information as required by the Companies Act and Listing Agreement.
- Those companies which are providing a lot of additional information are doing so in a variety of ways, thus making comparisons difficult.
- A number of companies have subsidiaries engaged in unrelated lines of business. Many have subsidiaries which are investment companies. However, no justification is offered to the shareholders of the parent company. Where loans and advances have been extended to loss making subsidiaries, no provision has been made by some companies.
- There are no shareholder communications by most companies other than periodical financial statements and notices of Annual General Meeting and Extraordinary General Meeting.
- Even the multinational companies desist from reporting as per the US GAAP as they can project a better performance if they follow the Indian GAAP as substantiated in the case studies. The only exception observed was of Colgate.

Palmolive Co Ltd following deferred tax accounting which is not mandatory as per Indian CAAP

- No distinction can be made in the level of disclosures between companies which have tapped international capital markets by issuing GDRs and companies which have not
- While rigorous statistical analysis has not been done a comparison of stock returns of companies selected for case study against return on BSE indicates that market does reward transparency
- Poor disclosures are generally made by companies whose business practices are questionable. Good disclosures reflect high level of corporate governance

VI. FIRE PROJECT RECOMMENDATIONS

Recommendations have been made for each of the following categories

- 1 General
- 2 One Time Disclosures
- 3 Continuing Disclosures on
 - Operations
 - Finance
 - Projections
 - Off Balance Sheet Items
 - Risks
 - Bankers
 - Rating
 - Legal Compliance
 - Investor Protection
 - Properties
 - Personnel & HR
 - Corporate Governance
 - Views of Retail Investors

A GENERAL AND ONE TIME DISCLOSURES

The Indian Securities Market is essentially individual oriented and therefore SEBI's main concern should be the protection of individual investors. Institutional investors, on account of their professional capability to research on firms, are in a better position to evaluate potential investments than individual investors. While a less regulated market will do for institution dominated markets it is necessary to maintain tight disclosure requirements for securities sold to individual investors.

To revive investor confidence in the securities market, it is vitally important to create an environment in which observance of rules and regulations becomes the norm and their breach the exception. For this, the regulation of the stock market should be entrusted to a single highly visible authority which can function independently with a strong statutory backing which is accountable to the investors and is therefore trusted by them. The success of the regulatory body in promoting the integrity and fairness of the markets will depend on their effectiveness in investigating and making public market abuses and in imposing deterrent penalties.

FIRE project is of the opinion that SEBI should take up studies to find out the present status and whereabouts of the projects and promoters of around 4000 public issues made during April '92 and March '96. The fly-by-night operators should be identified from amongst them and exemplary punitive action should be taken against them. Punishment should include impounding issue proceeds from the promoters and refunding the same to the investors.

Only the quality scrips which promise liquidity for the investors should remain listed on the stock exchange. Following alternatives can be considered to weed out the illiquid scrips

- Permit promoters to buy back the shares
- Before delisting the scrips make it mandatory for the promoters and merchant bankers to make an open offer to all investors to purchase the shares at a determined price

FIRE project recommends that SEBI should tighten the norms for new issues. Companies with no track record should be allowed to list only on the OICEX. Venture capital funds which aim to invest primarily in start up firms must also be encouraged.

Continuing disclosures, specially disclosures in annual reports, should be brought under the purview of SEBI. Presently, companies present annual reports as per Companies Act and as per the Listing Agreement.

FIRE project recommends setting up of depositories at two levels

- In SEBI at the national level and
- In stock exchanges at the regional level

Issuers should be required to file reports with SEBI and the Stock Exchanges where the shares are listed. These should be reviewed, monitored, checked for accuracy and consistency by trained professionals to be employed/ outsourced by them. SEBI and stock exchanges should be responsible for the prompt dissemination of material/ price sensitive information received by them.

FIRE Project recommends that SEBI should issue guidelines to all stock exchanges for setting up of a Public Reference Facility on a mandatory basis. One of the effective ways in which information can be disseminated quickly and in a cost effective manner is through the internet. SEBI and the stock exchanges should have a home page on the internet to which all filings can be posted. For this purpose, companies should be required to submit their filings in electronic form. The Public Reference Facility to be set up in stock exchanges should have adequate number of computer terminals to enable investors to have easy access to information on the internet.

B CONTINUING DISCLOSURES

1 Operations

The Bhave Committee on continuing disclosures standards has recommended to SEBI that while segment reporting is not prevalent in the Indian market, a beginning can be made by requiring all companies whose shareholder funds are more than Rs. 100 crore to compulsorily follow the practice of segment reporting and to extend the

requirement to all listed companies over a three year period. FIRE project also endorses the need for segment reporting.

SEBI should make it mandatory for companies to disclose details of exports and imports in the annual report. Information should include percentage of exports/ imports to total sales/ purchases, countries of export/ import and currencies to which there is risk exposure.

2 Finance

On recommendations made by the Bhive Committee, SEBI has directed stock exchanges to amend the listing agreement to incorporate the following disclosures:

- Publish unaudited financial results on a quarterly basis instead of a half yearly basis from June '98 onwards.
- Companies mobilizing funds from the public to publish details of deployment of funds on half yearly basis instead of yearly basis.
- Informing stock exchanges immediately of all those events that would have a bearing on the performance/ operations of company as well as price sensitive information.

FIRE project recommends the following with respect to disclosures on quarterly and half yearly basis:

- Quarterly/ half yearly reports published in newspapers may fail to draw the attention of investors. Companies should therefore mail these reports to shareholders on a mandatory basis.
- Rating on all fixed income securities issued by a company should be disclosed on a quarterly basis, changes in ratings and rating agency should be disclosed on the occurrence of event. In case of change in the rating agency, the reason for the same should be stated. If a company obtains multiple ratings, all such ratings should be disclosed.
- Quarterly reports should be audited and drawn up in the same format as the Annual Report.
- Notes to summary of results published on a quarterly basis should include explanations about significant deviations from performance during the previous period for which comparative figures are disclosed. It should also include past trend by way of percentage of revenues of each quarter in the previous year to total revenues for the year.
- Penalties, if any, imposed by regulatory authorities for non-compliance or violation of norms should be disclosed on a quarterly basis.
- Quarterly report on shares of the company dealt with during the quarter along with dates and the names of employees or connected persons.

FIRE Project recommends that the following additional disclosures be made mandatory in the Annual Reports

Additional Disclosures on Convertibles, Warrants etc

- Fully diluted EPS as per International Accounting Standard
- Shareholding pattern post conversion
- Options exercised in the case of stock options
- Due Dates on conversions

Management analysis of the financial statements using key ratios such as Earnings Per Share (EPS), Return on Net Worth (RONW), Debt Equity Ratio (DER) and Current ratio. It should also include comments on cash flow statement

FIRE Project notes that the gap between International and Indian Accounting Standards will be significantly reduced if Bhave Committee's recommendations on Consolidation of Accounts, Segment reporting and Deferred Tax liability are implemented after ICAI draws up Accounting Standards for the same.

3 Projections

FIRE Project is of the view that projections can be misleading and hence a possible source of misinformation and consequent unwarranted litigation. Management should not therefore be required to provide projections. Rather, they should provide information that helps users to forecast for themselves the company's future performance. Contrary to majority opinion which favours projections in annual report in addition to Offer document, FIRE Project recommends that management should only provide forward looking information on

- Opportunities and risks
- Management's plans including critical success factors
- Comparison of actual performance with previously disclosed opportunities, risks and plans

4 Off Balance Sheet Items

FIRE Project recommends the following additional disclosures to be made on a mandatory basis about the identity, financial impact, risks and obligations resulting from the following Off Balance Sheet items

- Contingent Liabilities
- Leased Asset
- Financial Instruments in the nature of Off Balance Sheet items

5 Risks

FIRE Project notes that the disclosure regarding risks to which the Companies and investors are exposed is grossly inadequate in the Offer Document and absent in the Annual Reports. The general response under 'Management perception' to most of the risk factors disclosed in offer documents is stated as follows:

'The risks are inherent in the business. The Company has put in place adequate risk control measures to manage these risks. This statement does not educate the investor on the level of risk exposure faced by him or her.'

It is therefore suggested that a risk management framework should be developed and disclosed by issuers covering major internal and external risks such as business risk, financial risk, interest rate risk and foreign exchange risk. The framework can include both policy and performance parameters.

6 Rating

FIRE Project recommends that rating on all fixed income securities issued by a Company should be disclosed on a quarterly basis. Changes in ratings and rating agency should be disclosed on occurrence of event. Report on change in rating agency should include reason for the same. If a Company obtains multiple ratings, all such ratings should be disclosed.

7 Legal Compliance and Investor Protection

FIRE Project recommends that SEBI should periodically publish/ widely disseminate information to investors on details of charges against the company, its promoters and top management on material issues. It is felt that such publicity would act as a strong deterrent to violation of norms by companies.

Disclosure on investor complaints on an annual basis should be made mandatory. The Company should give details of number of complaints received, settled, pending for more than 30 days, nature of comments and number of complaints received as a percentage of number of shareholders.

8 Group Companies and Subsidiaries

FIRE Project notes that the Bhave Committee has already made its recommendations to SEBI on consolidation of accounts and it reiterates the importance of the same.

- FIRE Project recommends that pending a guideline/ standard on consolidation of accounts as recommended by the Bhave Committee, it should be made mandatory for companies to value investments as per equity method.
- Such additional disclosure made by companies would enable investors to decide whether the transactions are at arms' length and at market determined terms.

9 Corporate Governance

Insider trading affects the integrity and fairness of the securities market. The use of price sensitive information by the investors for profit reduces the overall investor confidence in the market. While it is extremely difficult to pin down insider trading, the only effective way to curb the same is by companies adopting an internal code of conduct. Companies like Infosys have well laid down codes and have set up blind trusts for purchase and sales of the Company's shares by their top executives.

FIRE Project recommends that share ownership reporting and reporting of movement of shareholding by directors and officers having substantial managerial powers in a Company should be made mandatory. This will allow the market to track insider trading and thus prevent the practice. As of now, for instances of insider trading brought to its notice, SEBI takes up investigation post event. This does not protect the interest of genuine investors. Further, auditors should be precluded from holding shares of companies whose accounts are audited by them.

FIRE Project also recommends that SEBI should make it mandatory for all listed companies to adopt a Code of Conduct for prevention of insider trading which should cover the following salient points:

- Persons to whom the rules under the Code of Conduct would be applicable
- Definition of insider – unpublished price sensitive information and dealing in shares
- Prohibition on dealing, communicating or counseling
- Procedure for dealing in the shares of the Company by
 - Employees
 - Senior management
- Prohibition for dealing in shares before and after the end of a quarter and before and after a Board meeting
- Report to Board of Directors of the Company and SEBI
- Penalty for violation

The CEO of the Company should report compliance with the code of conduct to the Company's Board of Directors on a half yearly basis.

10 Views of Retail Investors

FIRE Project recommends that measures should be taken to increase awareness of investors' rights through investor education programs organized by the Stock Exchanges, Investor Associations or such other organizations. SEBI should be armed with adequate powers to enforce restoration to investors of moneys taken from them in violation of regulation, to impose fines, initiate criminal action and set up mechanism for quick redressal. This may be enabled if SEBI is vested with the powers of a civil court under the Code of Civil Procedures.

Disparity of dissemination of information to Institutional Investors and Retail Investors is wide. A centralized information depository if set up should not allow such disparities to exist.

India is perhaps the only country where new firms without track record can access public funds and get listed on major Stock Exchanges. The problem faced by individual investor in evaluating investment in such firms can be overcome if they are allowed to list only on the OTCEI. Venture capital funds, which aim to invest primarily in start up firms, must also be encouraged.

C FEASIBILITY OF STOCK EXCHANGES PLAYING THE LEAD ROLE IN DISSEMINATION OF INFORMATION TO INVESTORS

Investor participation has so far been restricted to urban areas. With 23 Stock Exchanges covering all of them, it is possible to disseminate information effectively through these Stock Exchanges provided there is a well equipped Public Reference Facility. FIRE Project recommends that SEBI should issue detailed guidelines to all Stock Exchanges on the minimum requirements to be met in setting up (on a mandatory basis) a Public Reference Library. It should have an adequate number of computer terminals to enable investors to have easy access to information on the internet.

As recommended by FIRE Project, a Disclosure Division must be set up at SEBI. Details regarding the same follow.

VII MODEL DISCLOSURE DEPARTMENT

FIRE Project has recommended the establishment of a Disclosure Department by SEBI. A Disclosure Department is key if the Indian securities market is to reflect the philosophy of regulation of the market backed by strong enforcement powers and liability for false and misleading information.

Full disclosure of information about an issuer, its financial condition and results of operations are essential to establish true market prices for shares. Furthermore, without the continuous flow of material information to the market, only insiders and large influential investors will have information and the ability to make sound investment decisions. A market that only serves insiders and large players excludes individual investors and results in complete loss of confidence in the country's financial markets.

Issuer disclosure, including financial reporting, is the most important component of a regulatory scheme essential to achieve the most basic of market functions. Information about an issuer, terms of its securities and financial condition of the issuer are critical to the integrity of the market.

Issuer reports can provide significant information. The scope and content of the information can be changed or improved with the adoption of specific disclosure requirements. This must be done at the regulatory level. The requirement for disclosure is intended to prevent the issuer from providing only half-truths or incomplete information.

We believe that SEBI does not currently have clearly defined statutory authority to take on the task of establishing ongoing reporting requirements or establishing and enforcing sanctions for non-compliance with reporting requirements. Further, this regulatory body is constrained in terms of trained personnel and facilities to monitor periodic reporting by public companies. Any meaningful periodic reporting program requires the ability to monitor the timeliness, quality and accuracy of the information. Without the ability to monitor and take corrective action, the risk of more misleading or incomplete information being provided to investors grows.

This is where the importance of having a separate Disclosure Department comes in. One of the most important reasons for establishing a Disclosure Department at SEBI is to provide for monitoring of the content, accuracy and timeliness of issuer reports. Unless the regulatory authority takes on this task, there is no way to ensure that issuers provide complete disclosure of all material events or the true financial condition. Therefore, a department within SEBI, with the specific legal authority to monitor and review issuer disclosure, can significantly improve the situation of issuer disclosure in India. Without a monitoring and review function at the regulatory level, the integrity of the market cannot be protected.

Another department within SEBI with the authority to take prompt corrective action against issuers who fail to file reports or file reports late is also necessary

A POWERS NECESSARY FOR THE ESTABLISHMENT OF A SUCCESSFUL DISCLOSURE DEPARTMENT AT SEBI

- The Disclosure Department must have the capability to establish rules, guidelines and standards for ongoing disclosure
- The Department must be able to monitor and review the activities of issuers and their disclosure obligations
- The Department must have the authority to require issuers to amend or revise disclosure documents if the Department determines that the existing disclosure is insufficient or misleading
- The Department may determine that the issuer has filed a misleading report or omitted material information from a report. The issuer may not have complied with a directive from the Disclosure Department to revise or amend a report. In such instances, the Disclosure Department must be able to recommend investigation by the Enforcement Division or other legal action against an issuer and its officers, directors, legal advisers and accountants
- The Disclosure Department must set the requirements for disclosure and the timing of the disclosure of material information
- The Disclosure Department must have the authority to require public dissemination of information by issuers

B PROCEDURES NECESSARY FOR THE DISCLOSURES DEPARTMENT

The following procedures need to be established for the smooth functioning of the Disclosure Department

- Establish procedures for the receipt, logging in, distribution and processing of issuer filings by the staff of the Department
- Issue industry specific disclosure guidelines for public companies
- Establish procedures for the internal review and commenting upon information contained in issuer reports and filings
- Develop procedures for communication with issuers by the staff of the Department
- Interpret laws and rules applicable to issuers in response to requests for clarifications or to address issues which may be novel or unique to that issuer
- Coordinate closely with the Office of the Chief Accountant to ensure that financial statements provide appropriate information
- Establish procedures to monitor all issuers to ensure that the required filings are submitted to SEBI on a timely basis
- Establish procedures to coordinate issues or filings with the other departments in SEBI and other government agencies as necessary and appropriate

The Disclosure Department will also protect shareholders by promoting sound corporate governance policies by ensuring that issuers always provide full and fair disclosure in their periodic reports.

The Disclosure Division should establish procedures to refer issuers to the Enforcement Division. Matters should be referred to the Enforcement Division if upon review of an issuer's filings the staff of the Disclosure Division determines that the issuer has released a report or made a filing that is false or misleading in any material way. The staff should also establish procedures to monitor if required filings are made on a timely basis. If an issuer repeatedly submits required disclosure documents late, the issuer should be referred to the Enforcement Division for some further action.

C PROPOSED STRUCTURE OF THE MODEL DISCLOSURE DEPARTMENT

The department should have the following offices:

- Office of Accounting Policy
- Office of Disclosure Policy
- Office of Shareholders' Rights
- Office of Public Filings
- Office of Records Management
- Office of Public Information or Reference

The **Office of Accounting Policy** should deal with all accounting matters for public issuers. The activities of this office should include:

- Co-ordination with the Institute of Chartered Accountants of India. There may be instances where the Accounting Office may determine that enhanced financial disclosure is appropriate for public companies. This may exceed the standards established by ICAI. However, the ability to set accounting standards for public companies that require additional disclosure standards for public companies is important.
- Co-ordination with IOSCO and IASB.
- supervision and ongoing training of staff accountants of the disclosure department.

The responsibilities of the **Office of Disclosure Policy** should include review and interpretation of the existing disclosure requirements. Additionally, this office should monitor disclosure norms and make recommendations for revisions, abolish unnecessary or duplicative requirements, establish new requirements when deemed appropriate, and issue interpretative guidelines when necessary. This office should also co-ordinate with other government agencies and offices regarding disclosure policy for companies. The disclosure process should not be overly burdensome for issuers while still ensuring that the investing public has access to all material information.

The **Office of Shareholder Rights** would be responsible for reviewing shareholder complaints. This office should also monitor corporate activities such as proxy solicitations, take-over, tender offers and buy-outs to ensure that minority shareholders have been provided with all material information regarding a business transaction and that their rights have been upheld.

Office of Public Filings should be the key office within the disclosure department. For it is this office that will have the day to day responsibility for the review and oversight of all issuer filings. This office should be staffed with chartered accountants, financial analysts and attorneys. The office should establish criteria and procedures for the review of filings. The purpose of this review is to ensure that issuers provide accurate and adequate information in their filings as required by SEBI law and regulations. This office should conduct full reviews of issuer filings. The review should include a comparison of prior filings and press releases with the current reports. This will monitor whether an issuer has issued an overly optimistic report in the past whereas in reality the issuer should have issued a press release reporting negative information for example. This is a key mechanism to ensure that the flow of information to the market is accurate and contains the complete picture about the condition of the issuer.

Office of Records Management is responsible for the maintenance the annual, quarterly reports and other filings by issuers and others required to be filed with SEBI. This office should maintain a records retrieval system to provide access for all documents, reports, attachments and other material filed. Ideally, this system should be "on line" and in electronic format to allow public access over the internet, news services and at a public reference room where terminals are provided to investors in order to access information at the public reference center maintained by SEBI. SEBI could impose a nominal fee for access to its services to cover the costs of maintaining this reference facility. The imposition of a fee would also discourage some of the more frivolous use of these reference facilities.

D STAFFING REQUIREMENTS

- Director
- Assistant directors
- Certified Public Accountants
- Financial analysts
- Attorneys
- Information Technology Specialists

The combination of professionals will permit the department to provide a broad range of services in connection with the ongoing disclosure obligations of issuers. These trained experts will carry out the examination process of issuer filings. Staff should develop specific skills or expertise in one or more industries. There will be issues unique to an industry and therefore it is recommended that certain staff members develop the ability to quickly and clearly address any industry specific issues that may arise.

APPENDIX I

ICFAI STUDY FINDINGS

STUDY ON DISCLOSURES

Report

Prepared By

The Institute Of Chartered Financial Analysts Of India

For

PW/FIRE Project

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I EXECUTIVE SUMMARY

- 1.1 Timely disclosure of information and dissemination of material information to the market are the salient features of a fair and transparent securities market. Investor confidence in the market is derived from availability of reliable information on an ongoing basis about issuers. At present, no single authority or regulatory body is responsible for ensuring continuous disclosure by issuers. While the listing agreements with stock exchanges provide for filing of annual, semi-annual and other reports on material/ price sensitive information, in the absence of penal provisions for non-compliance, stock exchanges do not have the means to enforce comprehensive ongoing disclosure obligations. Given the fact that the investor confidence in the Indian securities market is at its lowest ever, there is a dire need for improvement in standards of disclosure, for one or more public depositories for collection, monitoring and review of issue reports and other information and for an enforcement mechanism which enables swift corrective action to be taken by a central regulatory authority.
- 1.2 The PW/ICFAI Study on Disclosures under the USAID FIRE Project addressed these issues. A survey of end users of information viz. Institutional Investors including FIIs, Stock Exchanges, Stock Brokers, Opinion Makers and Retail Investors was conducted to identify their requirements and to find gaps in the existing norms and regulations for disclosure. In addition, case studies were conducted on 6 Indian companies of varying standards of disclosure to understand the relationship between the quality of disclosure and market capitalization.

1.3 Summary of findings of the Study Group based on the survey

1 Information dissemination

Disparity in dissemination of information - There seems to be a wide disparity in dissemination of information to different categories of investors - the FIIs and other institutional investors are perceived to be getting the best in terms of quality analysis and volume (FIIs seemingly the most favoured) and the retail investors the least - often just an outdated Annual Report. The different categories of investors are therefore in unequal bargaining positions. It is this which often forces the small investors to rely on market rumors, broker recommendations etc. while making investment decisions.

Delay - non-receipt of price sensitive material information

There is no mechanism to ensure quick dissemination of price sensitive material information. With no provision for share ownership reporting by directors, officers etc. to SEBI, most respondents felt that insider trading is rampant.

Role of stock exchanges

Most of the stock exchanges do not have the required infrastructure to review process and disseminate information based on filings made by issuers. They however agree that they must take the responsibility for dissemination of information to investors. The survey also revealed that the listing fee collected by the exchanges is adequate to cover the costs of providing such service.

2 Quality of disclosures and standards of disclosure

Investors are more concerned about the quality of disclosures made rather than the standards in vogue for disclosure. The Study revealed that the investors view the Indian Accounting standards to be good but the issuers follow them by letter rather

than by spirit. The respondents felt that this is facilitated by lack of regulatory monitoring and auditors' unwillingness to qualify the financial statements where it is warranted.

3 Enforcement

Lack of penal provisions for non-compliance is cited as one of the main reasons for poor information dissemination and poor quality of disclosures. The filings to be made by issuers as per listing agreement are not enforceable by stock exchanges as the only drastic step that they can take is delisting which hurts the investors more than the issuers. No action has been taken by SEBI on issuers who have vanished without a trace after raising funds through public issues.

1.4 Study Group Recommendations

The Study Group has read through the report of the Bhave Committee on Continuous Disclosures and its recommendations to SEBI. These recommendations when implemented will go a long way in improving ongoing disclosures by issuers and will narrow down the differences in accounting as per India GAAP and US GAAP. The central issue however is wider than just better disclosure standards. It is an issue of enforceability of norms and it is an issue of a single authority being responsible for timely dissemination of quality information.

The recommendations of the Study Group thus encompass three broad areas

- a) Improvement in information dissemination
- b) Further improvement in disclosures in the context of Malegam and Bhavani Committee recommendations
- c) Improvement in enforcement mechanism

a) Improvement in information dissemination

At present SEBI does not regulate or require ongoing disclosure by issuers. Issuers are required to comply with financial reporting provisions as per Companies Act 1956. In addition, SEBI directs stock exchanges from time to time to amend listing agreement with the issuers to incorporate clauses for additional disclosures to be made. The stock exchanges however lack proper mechanism to enforce compliance with listing agreement requirements.

The Study Group recommends that continuing disclosures should be brought under the exclusive purview of SEBI.

The Study Group recommends setting up of Information Depositories at two levels - In SEBI at the national level and in stock exchanges at the regional level. Issuers should be required to file reportings with SEBI and the stock exchanges where the shares are listed. These should be reviewed, monitored, checked for accuracy and consistency by trained professionals to be employed/outsourced by them. SEBI and stock exchanges should be responsible for prompt dissemination of material / price sensitive information received by them.

The Study Group recommends that SEBI should issue guidelines to all stock exchanges for setting up of a Public Reference Facility on a mandatory basis.

At present there seems to be a wide disparity in dissemination of information to different categories of end users. One of the effective ways in which information

can be disseminated quickly and in a cost effective manner is through the net. SEBI and the stock exchanges should have a home page on the internet to which all filings can be posted. For this purpose, companies should be required to submit their filings in electronic form. The Public Reference Facility to be set up in stock exchanges should have adequate number of computer terminals to enable investors to have easy access to information on the internet.

The Study Group recommends that Share Ownership reporting and reporting of movement of shareholding by directors and officers who have substantial managerial powers of a company should be made mandatory. This will allow the market to track insider trading and thus prevent the practice. As of now, SEBI takes up investigation post event of instances of insider trading brought to its notice. This does not protect the interest of genuine investors. Further, auditors should be precluded from holding shares of the companies whose accounts are audited by them. **The Study Group also recommends** that SEBI should make it mandatory for all listed companies to adopt a Code of Conduct for prevention of insider trading which should cover the following salient points:

- Persons to whom the rules under the Code of Conduct would be applicable
- Definitions of 'Insider', 'unpublished price sensitive information' and 'dealing in shares'
- Prohibition on dealing, communicating or counseling
- Procedure for dealing in the shares of the company by
 - employees
 - senior management
- Prohibition for dealing in shares before and after the end of a quarter and before and after a Board meeting
- Report to Board of Directors of the Company and SEBI
- Penalty for violation

The CEO of the company should report compliance with the code of conduct to the company's Board of Directors on a half yearly basis

b) Further improvement in disclosures

The Study Group recommends as follows

1. Disclosures in Annual Reports - Mandatory

- The annual report should include a historical background of the company and its business in order to improve the understanding of the financial statements. Besides the scope and description of business, it should also include broad objectives and strategies and impact of industry structure on the company.
- Historical data for the last five years should be given to enable analysis of trends and relationships to predict future earnings. It should segregate core and non-core activities as it is the company's core activities (usual and recurring events) which provide the relevant information from which predictions can be made about the future.
- Balance sheet should be reformatted to disclose assets and liabilities in order of liquidity. Current liabilities should be disclosed separately.
- Profit and loss account should be reformatted to disclose gross profit.
- The following additional disclosures should be made on convertibles, warrants and stock options:
 - Fully diluted EPS as per International Accounting Standard
 - Shareholding pattern post conversion
 - Due dates of conversion
 - Options exercised in the case of stock options
- Following details about exports and imports should be given:
 - Percentage to total sales/purchases
 - Countries of export/import
 - Currencies to which there is risk exposure

- Off balance sheet items- Adequate disclosures should be made about the identity financial impact risks and obligations resulting from the following off balance sheet items
 - Leased assets
 - Contingent liabilities
 - Financial instruments in the nature of off balance sheet items
- Management analysis of the financial statements using key ratios such as Earnings Per Share (EPS) Return On Networth (RONW) Debt Equity Ratio (DER) and Current ratio. It should also include comments on cash flow statement
- Share performance - A graph to be included showing share price movements during the reporting period against BSE or any other suitable index. It should also disclose volumes of trading
- Following details of investor complaints should be included
 - Number of complaints received during the reporting period
 - Number of complaints settled
 - Number of complaints pending for more than 30 days
 - Number of complaints received as a percentage of number of shareholders
 - Nature of complaints

2 Disclosures in Annual Reports - Optional

- Forward looking information which would help users to forecast for themselves the company's financial future
- A risk management framework may be developed and disclosed covering major internal and external risks such as business risk, financial risk, interest rate risk and foreign exchange risk. The framework can include both policy and performance parameters
- Information on high and low of share price during the reporting period

3 Disclosures in Quarterly Half yearly and other reports

- Quarterly / Half yearly reports published in newspapers many a times fail to draw attention of investors. Companies should therefore mail these reports to shareholders on a mandatory basis.
- Rating on all fixed income securities issued by a company should be disclosed on a quarterly basis. Changes in ratings and rating agency should be disclosed on occurrence of event. Report on change in rating agency should include reason for the same. If a company obtains multiple ratings, all such ratings should be disclosed.
- Half yearly reports should be audited and drawn up in the same format as Annual Report.
- Notes to summary of results published on a quarterly basis should include explanations about significant deviations from performance during the previous period for which comparative figures are disclosed. It should also include past trend by way of percentage of revenues of each quarter in the previous year to total revenues for the year.
- Penalties if any imposed by regulatory authorities for non-compliance or violation of norms should be disclosed on a quarterly basis.
- Quarterly Report on shares of the company dealt with during the quarter along with dates and the names of employees or connected persons.

c) Improvement in Enforcement Mechanism

The Study Group concludes that SEBI should bring in such measures to regulate the securities market as would enable it to emerge as a single, highly visible authority which can function independently with a strong statutory backing. Above all, it should win the confidence of investors. **The Study Group recommends that** towards the end SEBI should take the following steps preparatory to improving disclosures:

- SEBI should take up studies to find out the present status and whereabouts of the projects and promoters of around 4000 public issues made during April 1992 and March 1996 identify the fly-by-night operators from among them and take exemplary punitive action against them. Punishment should include impounding of issue proceeds from the promoters and refunding the same to the investors.
- Following alternatives can be considered to weed out the numerous illiquid scrips listed on the stock exchanges
 1. Permit promoters to buy back the shares
 2. Before delisting the scrips make it mandatory for the promoters and merchant bankers to make an open offer to all the investors to purchase the shares at a determined price
- SEBI should tighten the norms for new issues. Companies with no track record should be allowed to list only on the OTCEI

The Study Group further recommends that SEBI should periodically publish/widely disseminate information to investors on details of non-compliance by listed companies. Such publicity would act as a strong deterrent to violation of norms by issuers.

The Study Group recommends that SEBI should draw up penalty structure for different categories of non-compliance and enforce the same quickly and meticulously. For this to be effective SEBI should be armed with adequate powers not only to impose fines but also to restore moneys to investors taken in violation of regulations, to initiate criminal action and to have a mechanism for quick redressal of investor grievances. This may be enabled if SEBI is vested with the powers of a civil court under Code of Civil Procedures.

1.5 Summary of findings of the Study Group based on Case Studies

1. Companies display the tendency to shout good news and suppress bad news. When performance is good, detailed commentaries form part of Directors' report, comparing performance with previous years, including graphic presentations of the positive trend. Such disclosures are reduced to minimum when performance is adversely affected.
2. Some companies, particularly the larger ones, are already providing information that substantially meets the requirements of various end users. Majority of the companies, however, provide the bare minimum information as required by the Companies Act and Listing Agreement.
3. Those companies which are providing a lot of additional information are doing so in a variety of ways, thus making comparisons difficult.
4. A number of companies have subsidiaries engaged in unrelated lines of business. Many have subsidiaries which are investment companies. However, no justification is offered to the shareholders of the parent company. Where loans and advances have been extended to loss-making subsidiaries, no provision has been made by some companies.
5. There are no shareholder communications by most companies other than periodical financial statements and notices of AGM and EGM.
6. Even the multinational companies desist from reporting as per US GAAP as they can project performance in a better light if they follow Indian GAAP, as substantiated in the case studies. The only exception observed by us was Colgate Palmolive Co. Ltd. following deferred tax accounting which is not mandatory as per Indian GAAP.
7. No distinction can be made in the level of disclosures between companies which have tapped international capital markets by issuing GDRs and companies which have not.

- 8 While rigorous statistical analysis has not been done a comparison of stock returns of companies selected for case study against return on BSE indicates that market does reward transparency
- 9 Poor disclosures are generally made by companies whose business practices are questionable Good disclosures reflect high level of corporate governance

1.6 Recommendations based on Case Study Findings

Good disclosure practice should result in the user understanding

- the linkage between events affecting the company and their financial impact
- factors that create long term value for the company
- management's vision
- quality of earnings
- opportunities and risks of an investment or lending decision

With this in mind, the Study Group recommends the following

- 1 Along with a historical background of the company giving scope and description of the company's business the vision statement broad objectives and strategies and what the management believes to be the core business should also be disclosed
- 2 In addition to financial statements and related statutory disclosures management analysis of the financial and non-financial data should be provided giving explanations for changes in operating financing and performance related data
- 3 Transactions among related groups/companies should be clearly disclosed to understand if they were conducted at arm's length
- 4 Proper justification should be given for investments in subsidiaries especially if they are in unrelated lines of business Management should clearly outline benefit to shareholders of parent company Pending a comprehensive standard on

- consolidation of accounts as recommended by Bhavc Committee it should be made mandatory for companies to value investments as per equity method
- 5 Companies should be required to make full provision for loans and advances which are doubtful of recovery and are unsecured. Further, companies should be required to account for interest on such loans and advances on cash basis. Companies should be required to follow the Reserve Bank of India guidelines to banks for asset classification, income recognition and provisioning under Prudential Norms.
 - 6 Cash flow statements provide valuable information to users analysing company's performance. For further value addition, explanatory notes should form part of management discussion and analysis of financial performance.
 - 7 Companies should highlight in the Annual Reports significant changes, additions and deletions to disclosures as compared to previous Annual Report.
 - 8 All communications to shareholders should contain only such information for which the company's management is the best source. Management should therefore exclude information about competitors for which it may not have complete or accurate knowledge.

2 BACKGROUND

2.1 The Indian economy in recent times has witnessed a number of initiatives on reforms to strengthen domestic financial sectors to better withstand the risks and vicissitudes of an open international financial environment. With the economy on a strong base, what is required to attract foreign investors and woo back domestic retail investors, apart from an improvement in clearing and settlement systems and other infrastructure, is better disclosure standards and transparency in operation of issuers of securities. Disclosure and transparency have been the focus of much supervisory attention and significant progress is being made in restructuring financial regulatory and surveillance activities in line with developments in international markets. After Malegam Committee whose recommendations on improving disclosures in offer documents were accepted and notified by SEBI, the Bhave Panel has submitted its report to SEBI on continuing disclosures standards. Some of the recommendations have been given effect to by SEBI giving a directive to stock exchanges to amend listing agreement. Other recommendations can be given effect to after ICAI examines the recommendations and prepares standards / guidance notes.

1. A full disclosure system should ensure that investors receive material information, foster investor confidence, contribute to the maintenance of fair and orderly markets, aid capital formation and prohibit fraud in public offering, trade, voting and tendering securities. The Indian capital market suffers from lack of information and lack of reliable information. There is no trading in over 4000 stocks out of 6752 listed on BSE. The fault lies with all the three participants in the market namely, the regulator, the issuer and the investor. While the investor has become wiser after incurring huge losses, the regulator has to take stringent action against flouting issuers to revive the investor confidence in the regulator body and the issuer should improve disclosures tremendously to revive the

market. In general, Indian market players have to develop systems and processes that create and sustain the faith of investors. The process is well under way and has to be pushed through to ensure a mature market in the near future.

2. Among those involved in the financial reforms process is Price Waterhouse LLP Financial Institutions Reforms and Expansion (FIRE) Project which under a contract with USAID is working on further advancement of capital markets in India. As part of the FIRE project, Price Waterhouse is working on improving ongoing disclosure by issuers. This is a priority area which needs to be addressed in order to ensure that the market is fair and transparent and there is a level playing field for institutional investors and the small investors.
3. The Institute of Chartered Financial Analysts of India (ICFAI) has associated with Price Waterhouse in this project on several disclosure related issues. It may be pertinent to note that ICFAI represents India in the Asian Security Analysts Federation (ASAF), Australia and is a member of the International Coordination Committee (ICC) of Financial Analysts Association, Paris.

2.2 Purpose

The present study is concerned with examining the feasibility of improving existing norms of issuer ongoing disclosure and dissemination of information and possibly establishment of a centralised information depository for easy and accurate collection and dissemination of information about corporations.

3 TERMS OF REFERENCE

- 3.1 The terms of reference of the study undertaken by ICFAI are detailed below.

1. To conduct an independent survey of end users of information viz Institutional Investors - domestic and foreign, stock exchanges, stock brokers, opinion

makers and retail investors and to analyse and compare the results of the survey to the existing disclosure practices being followed by companies operating in India. The report shall identify gaps in the existing disclosure practices and the needs of the end users.

2. To conduct case studies on Indian companies whose disclosure standards are higher either because the Company has tapped international capital markets or because the Company has voluntarily adopted international standards for disclosure. It will also include companies which are meeting the existing disclosure requirements under Indian laws and regulations.

4 MEMBERS OF THE ADVISORY PANEL AND STUDY GROUP

4.1 The following are the members of the Advisory Panel

1. Prof. S. Sundararajan
Professor Finance &
Coordinator Centre for Entrepreneurial Studies
Indian Institute of Management
Bangalore
2. Prof. V. Raghunathan
Chairman Finance & Accounting Area
Indian Institute of Management
Ahmedabad

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3 Mr T V Mohandas Pai
Senior Vice-President & CIO
Infosys Technologies Limited
Bangalore

4 Dr V Panduranga Rao
Director
ICFAI Business School
Hyderabad

4.2 The Study Group comprises of the following members

Prof T R Venkatesh Project Manager
Dean ICFAI Business School (IBS)
Bangalore

Prof Bala Bhaskaran
Dean IBS Ahmedabad

Prof Kalyan Debnath
Dean IBS Calcutta

Prof V R K Chary
Associate Dean IBS Hyderabad

Prof C Pradeep
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Prof. Lata Chakravarthy
Faculty IBS Bangalore

Prof. Malathi Srinivasan
Faculty IBS Bangalore

Prof. M.K. Geetha
Faculty IBS Chennai

Prof. T. Ravikumar
Faculty ICFAI Hyderabad

Prof. Latha Rani K
Faculty IBS Bangalore

5 SURVEY AND CASE METHODOLOGY

5.1 Design of survey

The survey was designed to ensure that findings were representative of a broad group of end users and to distinguish between the type of information they really need and the types that they may find interesting but may not be relevant for an investment decision.

5.2 Selection of respondents

The survey covered the following categories of end users as respondents:

1. Institutional investors including foreign institutional investors
2. Stock Exchanges
3. Stock Brokers
4. Opinion Makers
5. Retail Investors

5.3 Design of Questionnaires

Separate questionnaires were designed for each of these categories except for opinion makers who were administered the same questionnaire meant for institutional investors. Formats of questionnaires for each category are included under Appendix I. While most of the questions were common, additional questions were included for stock exchanges and stock brokers to elicit information on the infrastructure available with them for receipt, processing, storage, retrieval and dissemination of information. The questionnaire for retail investors was brief and less technical.

5.4 Number of respondents

The following table shows area-wise and category-wise number of respondents to the survey. The list of respondents is given in Appendix II.

Category → Area ↓	Institutional Investors	FII's	Stock Exchanges	Stock Brokers	Opinion Makers	Retail Investors	Total
Ahmedabad		1	2	9		7	19
Bangalore	1		1	4	2	11	19
Calcutta	6		3	20	3	54	86
Chennai	5	1	3	11	12	50	82
Delhi	2	1	2	15	11	53	84
Hyderabad	2		1	6	5	25	39
Mumbai	18	5	3	13	12	47	98
Total	34	8	15	78	45	247	427

5.4 Administration of questionnaires

The questionnaires were administered by researchers selected by ICF AI Business School from among its students based on their knowledge of capital markets, communication skills, etc. In the Institutional Investor category the questionnaires were administered to persons in top management cadre namely CEO/ MD/ Fund Manager/ Head of Research/ Head of Investments. In the Stock Exchange category the questionnaires were administered to the Executive Director of the exchange. In the stock broker category the respondents were either partners or managers of the broking firm.

The Opinion Makers included business editors of financial newspapers and business magazines, analysts of institutional investors, financial analysts, financial and management consultants, advocates and chartered accountants. The retail investors were selected from among high networth individuals based on references from stock exchanges and stock brokers.

Respondents located in major cities (four metros and Ahmedabad, Bangalore, Pune and Hyderabad) were personally interviewed. Respondents located outside these cities (stock exchange, stock brokers and opinion makers category only) were mailed the questionnaires.

5.6 Method of Analysis

The responses were analysed category-wise to map divergence in views, if any, on the same questions among different categories. The differences found have been highlighted by way of graphs for each category along with reasons for such variations. Where all categories have held the same view, a consolidated picture is given. Analysis of responses of individual categories or of two or three

categories but together is given in the form of 3-D Pie charts. Where a consolidated picture of all categories is given bar chart is used.

Graphical Analysis has been done for key questions seeking yes or no answers followed by explanations for variations in responses among different categories and other significant comments made by respondents related to the question.

For other key questions (not structured in yes or no format) analysis is presented as appropriate for each question in the form of rankings, tables, summary of important suggestions, observations, etc.

For the rest of the questions result of analysis is given by way of statements reflecting majority view. In addition a complete tabulation of category-wise responses to each question is given in Appendix III.

5.7 Case Methodology

1. Companies selected for case study are grouped under three categories. The names of the companies under each category are given below.

Category I (Companies which have issued GDRs)

1. Arvind Mills Ltd
2. Finolex Cables Ltd

Category II (Companies which have voluntarily adopted higher disclosure standards)

1. Infosys Ltd
2. Colgate Palmolive (India) Ltd

Category III (Companies which meet the existing disclosure requirements as per Indian regulations)

- 1 Duncans Industries Ltd
- 2 Dr Reddy s Laboratories Ltd

2 The following information was collected from the companies

- 1 Names of stock exchanges where the company s shares are listed
- 2 Shareholding pattern including number of shareholders
- 3 Annual reports of the last three years
- 4 Copy of Offer Document if the company had made any public/rights offer in the last three years
- 5 Copies of published half yearly results for the last one year (paper cutting)
- 6 Copies of Press release/Press reports
- 7 Copies of all communications sent to shareholders in the last one year including notices of AGMs and EGMs
- 8 Copies of all communications to and filings with stock exchanges
- 9 Copies of reports sent to SEBI during the last one year
- 10 Dates of Board Meetings held during the last two years and significant issues discussed therein
- 11 Copies of any special reports sent during last year to Institutional Investors / NRI investors/Investors with large shareholdings
- 12 Prevention of Insider Trading- Format of share ownership reports if any received from company executives/directors/auditors and other insiders and sent to SEBI or any other regulatory body

3 The following additional information was collected from companies listed under categories I and II

- i) Copies of filings during the last one year with U.S. SEC or with any other regulatory authority pursuant to GDR issue
 - ii) Changes in Annual report consequent to issue of GDR
- 4 A questionnaire was administered to the CEO/Company Secretary of the company
- 5 The Case Study reports are organised under the following headings
 - a History and background of the company
 - b Shareholding pattern
 - c Comments on disclosures in Annual Reports
 - d Comments on disclosures in Half Yearly Reports
 - e Comments on other shareholder communication
 - f Share Price Movements-Observations
 - g Qualitative Evaluation of disclosure standards and correlation with market capitalisation
 - h Conclusion

The case studies are included in Appendix IV

6 ANALYSIS OF SURVEY FINDINGS

6.1 Responses to questions listed under the General section of the questionnaires

The questions under this section were intended to get an idea of the end users' perceptions about the attributes of information, important sources of information, additional information required to make informed investment decisions, present state of the capital market, the disclosure practices of companies, the role being played by the regulatory authorities and stock exchanges and what is expected of them.

- 1 The respondents' views were divergent on the attributes of information which are relevant for investment decisions. Many of them expressed that all attributes are important and they are complementary.
- 2 Annual reports and Offer documents were considered to be the most important sources of information. The retail investors ranked research reports also as important.
- 3 The additional information required by most respondents to make informed investment decisions were (in order of priority)
 - Economic, Industry and Company Analysis
 - Analysis of financial statements
 - Views of largest stakeholders other than promoters
- 4 Q Do you think information about any company easily available?

Findings

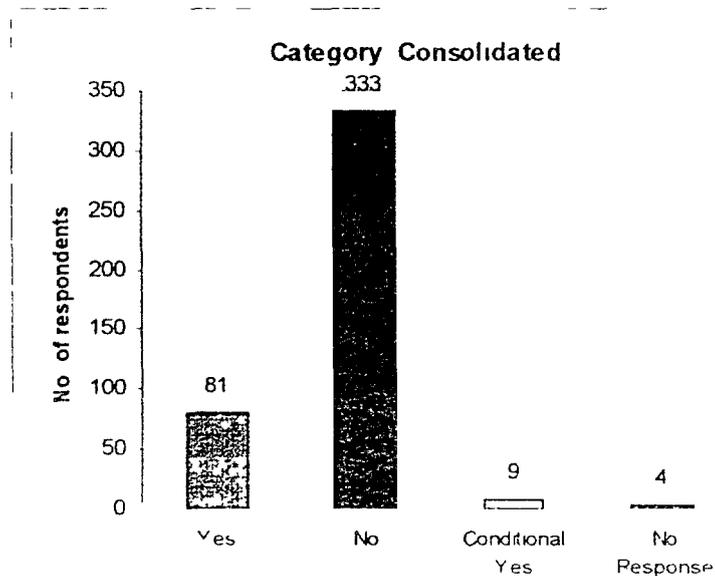


Fig 1

63

Observations

333 respondents constituting 78% of the total respondents said no as may be seen in Fig 1. Those who said yes were of the opinion that if you have the initiative intelligence and resources, there is no difficulty in gathering the required information. The retail investors were uniformly of the view that no information other than the annual report is accessible. Even the annual report is available after considerable delay. They also felt that good news gets disseminated immediately whereas price sensitive adverse information can be accessed after a time span of one month or more.

5 Q Do you think that creation of a centralised information depository is required?

Findings

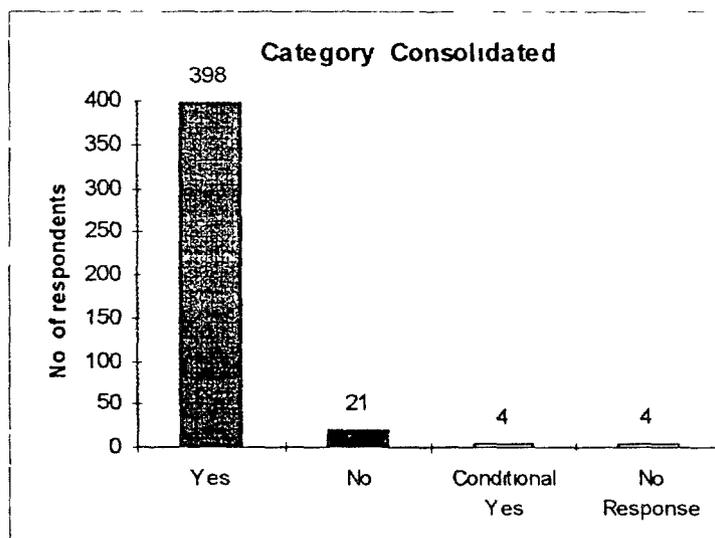


Fig 2

Observations

The respondents were near unanimous in voting for a centralised information depository. Those who have responded in the negative feel that it is the

64

responsibility of stock exchange to disseminate information to investors in that region

6 Q Do you think Stock Exchanges should take a greater role in disseminating information?

Findings

Category Opinion Makers Stock Brokers and Retail Investors

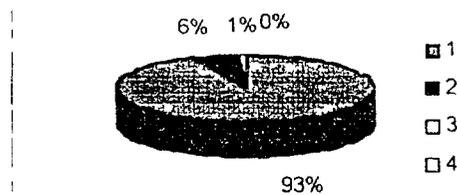


Fig 3 1

Category Institutional Investors

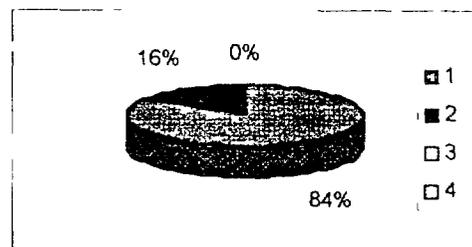


Fig 3 2

Category Stock Exchanges

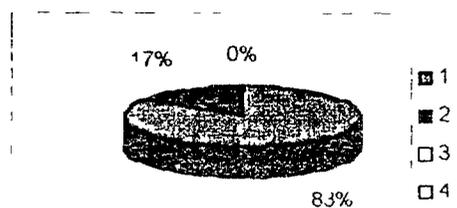


Fig 3 3

1 Yes 2 No 3 Conditional Yes 4 No response

65

Observations

While, overall 94% have said yes (including 'Conditional Yes') and 6% have said no, the percentage of respondents who have said 'no' among Stock Exchange and Institutional Investor category is higher at around 16%. It was observed that Stock exchanges who have said 'no' have explained that it is not possible for them to assume a greater role. Institutional Investors on the other hand have said 'no' indicating that if there is a centralised information depository it is not required of Stock Exchanges to play a greater role.

- 7 Q Would you prefer some professional information providers to collect required information from corporates on a continuous basis, collate and furnish the same?

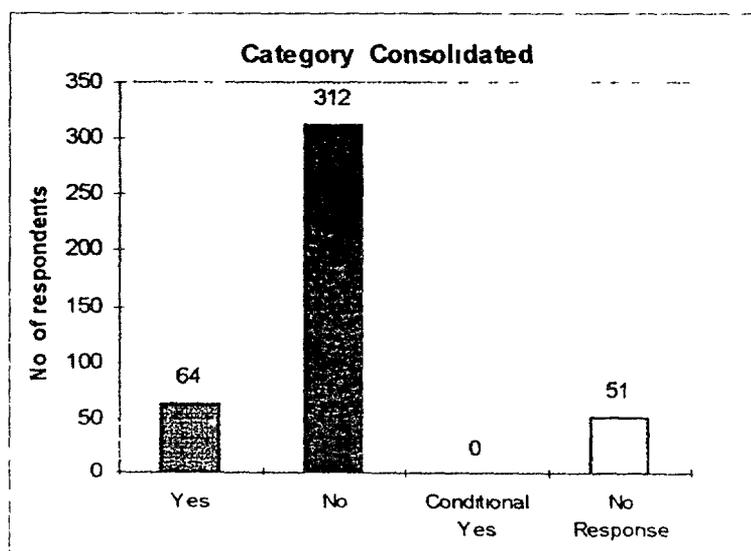
Observations

83% of the respondents were in favour of professional information providers to be involved in collecting information from companies on a continuous basis, collating and furnishing the same to the end users at a cost. Those who were not in favour doubted the reliability of such information.

- 8 Q Do you believe that the existing disclosure norms are adequate?

Findings

Fig 4



60%

Observations

Majority of the respondents felt that the disclosure norms are inadequate. Some of those who said 'yes' explained that norms are adequate but what is lacking is transparency on the part of issuers and proper monitoring on the part of regulatory authorities.

9 Q Do you think companies are adhering to existing disclosure norms?

Findings

Category Institutional Investors

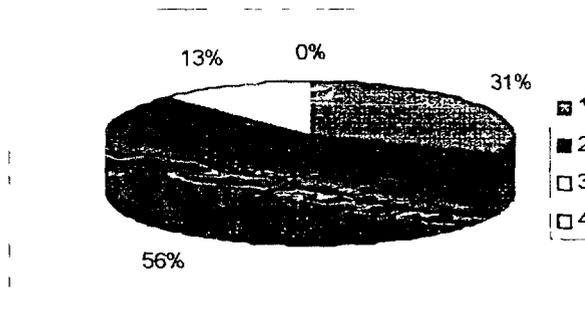


Fig 5 1

Category Others

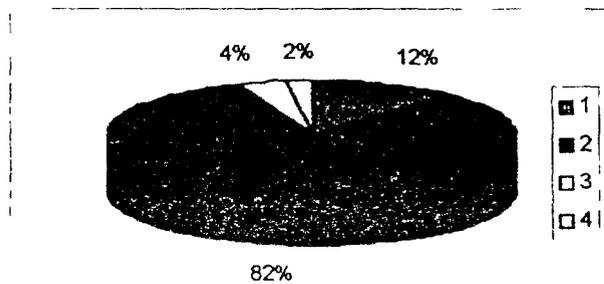


Fig 5 2

1 Yes 2 No 3 Conditional Yes 4 No response

Observations

The Institutional Investors held a divergent view 44 % (including ‘Conditional Yes’) of them thought that companies adhere to norms as against 16% (including Conditional Yes’) of the other categories. During discussions with respondents from Institutions it was gathered that in their opinion the compliance or adherence is in letter but not in spirit. For example the annual report may be in the required format with the required information but it may still not give a true and fair picture.

The reasons for companies not adhering to disclosure norms were attributed to the following as per analysis given below

- Lack of regulatory monitoring and oversight
- Lack of insistence by auditors and
- Loopholes in the norms

10 Q Do companies deliberately mislead investors?

Findings

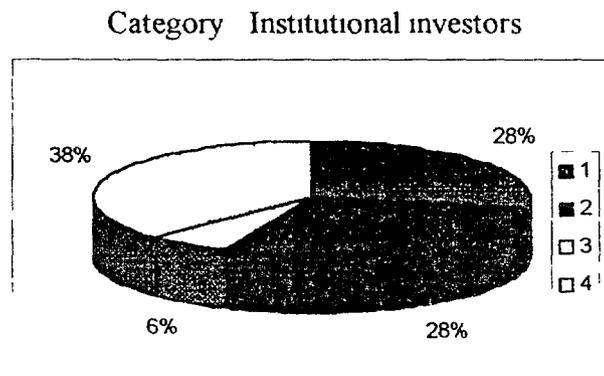


Fig 6 1

1 Ycs 2 No 3 Conditional Yes 4 No response

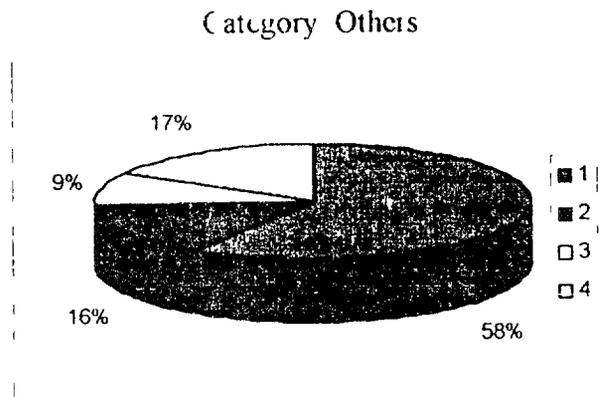


Fig 6 2

1 Yes 2 No 3 Conditional Yes 4 No response

Observations

As against 67% (including Conditional Yes) of respondents in all other categories, only 34% (including 'Conditional Yes') of the Institutional category of respondents believe that companies deliberately mislead investors. It may also be observed that the percentage of ' No response' is very high in the Institutional category at 38%

Many of those who said yes added that it generally takes the form of ' Window dressing' of financial statements

From an analysis of additional information given, two reasons may be attributed to Institutional Investors not agreeing with other respondents

- a) In general, the investments of Institutional Investors are in 'A' category shares which are of companies with high market capitalisation and better disclosure standards
- b) It is difficult to generalise and say that all companies do or do not mislead investors

The high percentage of ' no response' can also be attributed to the same reason as (b) above

67% of the respondents who said 'yes' attributed the reason for companies deliberately misleading the public to 'companies not caring for the needs of the investors'

- 11 The suggestions made on steps to be taken to prevent companies giving misleading information were
- Management and auditors to be held accountable
 - Penal provision
 - Criminal action
- 12 Q Do you observe any correlation between the willingness to part with information and performance of the company ?

Observations

The institutional investors felt that there is a correlation between willingness to part with information and the performance of the company. The opinion makers felt otherwise, if the performance of a company is generally good, it is easy to convey some bad news without attracting too much of attention.

- 13 Q What is the general time gap between the availability of information and its accessibility to investors?

Majority of investors said that they had access to information 1-3 months after it is made available by the company. Majority of the retail investors said that they had access to information after 3 months.

- 14 Q What is your opinion about the reliability and accuracy of information made available in financial reports?

Observations

The respondents rated the sources as follows (listed in descending order of reliability/accuracy)

- 1 Stock exchanges/Regulatory authorities
- 2 Industry and Trade Associations
- 3 Research reports
- 4 Finance & Business magazines
- 5 Financial newspapers
- 6 Survey reports
- 7 TV (only good news gets disseminated through this source)
- 8 Seminar & Conference papers

6.2 One time disclosure

- 1 Q Are you generally satisfied with the objects of the offer disclosed in the prospectus?

60% of the respondents were not satisfied with the objects of offer disclosed. Many of them expressed the view that it is what is intended rather than what is stated which is questionable.

- 2 Q Would you require additional disclosures if the issue is to meet working capital need only? If yes, would you require the appraisal to be made by banks/financial institutions even if the issuer has no borrowings?

Majority of investors were in favour of additional disclosure if the issue is for working capital needs only. On the question of whether a bank appraisal should be insisted if the issue is only for raising working capital, the respondents felt that more than bank or institutional appraisal (they seemed to have better faith on appraisal by FIs than by banks) there should be additional disclosure on

- (i) why the issuer is not raising funds from the banks and
- (ii) detailed assessment of working capital requirement

3 Q Would you consider it relevant for the issuer company to disclose its mission and long term strategy in its offer document?

The respondents felt that disclosure of mission and long term corporate strategy in the offer document would serve a limited purpose and instead if the company gives a brief on the core businesses of the company, it will serve the purpose of understanding whether the company is heading in the right direction

4 Q Do you think the capital market is adequately monitored and supervised?

Findings

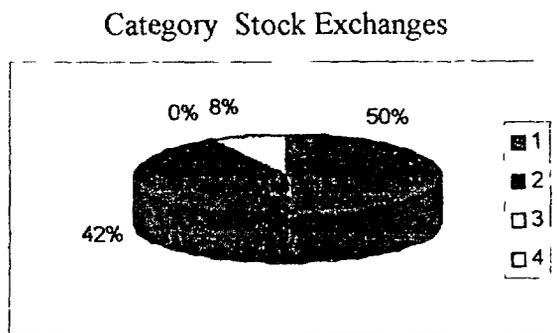


Fig 7 1

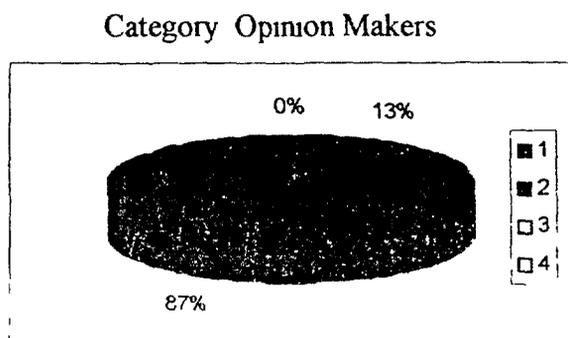


Fig 7 2

1 Yes 2 No 3 Conditional Yes 4 No response

72

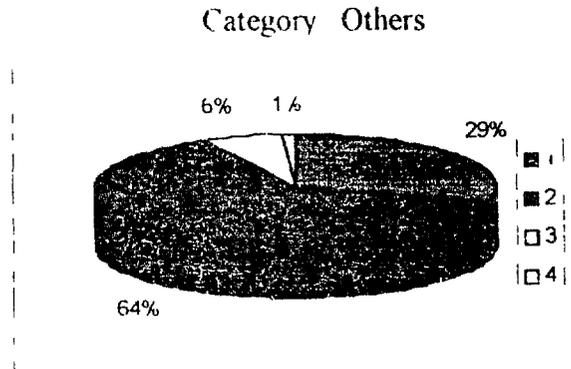


Fig 7.3

1 Yes 2 No 3 Conditional Yes 4 No response

Observations

It may be observed that 50% of the Stock exchanges feel that the capital market is adequately monitored. Majority of respondents in all other categories think otherwise, especially, Opinion Makers where 87% of the respondents feel it is not adequately monitored.

Suggestions on what needs to be done to improve supervision of capital markets converge on the following -

- Regulatory authority to tighten disclosure norms with strong penal provisions for non compliance
- Stringent norms for listing and delisting
- Professionalisation of management of stock exchanges
- Reduction in number of companies listed on the exchanges
- Improvement in infrastructure
- Auditors to give detailed qualifications to financial statements
- Management and auditors to be held accountable to both the regulatory authorities and shareholders while the regulatory authorities to be held accountable to the shareholders

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6.3 Recommendations of the Study Group

The Indian Securities Market is essentially individual oriented and therefore SEBI's main concern should be protection of individual investors. Institutional investors on account of their professional capability to research on firms are in a better position to evaluate potential investments than individual investors. While a less regulated market will do for institution dominated markets, it is necessary to maintain tight disclosure requirements for securities sold to individual investors.

In order to revive investor confidence in the securities market it is vitally important to create an environment in which observance of rules and regulations becomes the norm and their breach the exception. For this the regulation of the stock market should be entrusted to a single highly visible authority which can function independently with strong statutory backing which is accountable to the investors and is therefore trusted by them. The success of the regulatory body in promoting the integrity and fairness of the markets will depend upon their effectiveness in investigating and making public market abuses and in imposing deterrent penalties.

The study group is of the opinion that SEBI should take up studies to find out the present status and whereabouts of the projects and promoters of around 4000 public issues made during April 92 and March 96, identify the fly - by - night operators from among them and take exemplary punitive action against them. Punishment should include impounding issue proceeds from the promoters and refunding the same to the investors.

Following alternatives can be considered to weed out the illiquid scrips listed on stock exchanges so that only quality scrips which promise liquidity for the investors remain listed.

- Permit promoters to buy back the shares

- Before delisting the scrips make it mandatory for the promoters and merchant bankers to make an open offer to all the investors to purchase the shares at a determined price

SEBI should tighten the norms for new issues. Companies with no track record should be allowed to list only on the OTCEI. Venture capital funds which aim to invest primarily in start up firms must also be encouraged.

Continuing disclosures especially disclosures in annual reports should be brought under the purview of SEBI. Presently companies present annual report as per Companies Act and as per Listing Agreement.

The Study Group recommends setting up of Information Depositories at two levels - In SEBI at the national level and in stock exchanges at the regional level. Issuers should be required to file reportings with SEBI and the stock exchanges where the shares are listed. These should be reviewed, monitored, checked for accuracy and consistency by trained professionals to be employed/outsourced by them. SEBI and stock exchanges should be responsible for prompt dissemination of material / price sensitive information received by them.

The Study Group recommends that SEBI should issue guidelines to all stock exchanges for setting up of a Public Reference Facility on a mandatory basis. One of the effective ways in which information can be disseminated quickly and in a cost effective manner is through the net. SEBI and the stock exchanges should have a home page on the internet to which all filings can be posted. For this purpose companies should be required to submit their filings in electronic form. The Public Reference Facility to be set up in stock exchanges should have adequate number of computer terminals to enable investors to have easy access to information on the internet.

6.4 Information Disclosure - Continuing disclosures

6.4.1 Operations

Questions under this section were on whether the end users would like to have certain additional information on the companies operations exports imports technology expenditure on research and development patents held major customers suppliers etc and if such information is required the frequency of reporting and the source document (e.g. Annual report Quarterly / Half yearly report Offer document)

- 1 The respondents were strongly in favour of segmental reporting giving details of operations product/division-wise on a quarterly basis. The QIS report which is already being furnished to the banks can form the basis of such reporting.
- 2 The respondents wanted the earlier practice of disclosing details of exports and imports in the annual report to be restored. The disclosure should include countries of import/export and currencies in which the transactions take place.
- 3 Information on major customers and suppliers were not considered relevant and it was felt that the companies would be reluctant to share such information.
- 4 Changes in technology/technical collaboration etc can be disclosed in the annual report or on occurrence of event.
- 5 Considering that the amounts spent on R&D by Indian companies are insignificant with the exception of some industries like pharmaceuticals information on R&D expenditure was not found to be required by the respondents.

6.42 Recommendations of the Study Group

The Bhave Committee on continuing disclosures standards has recommended to SEBI that while segment reporting is not prevalent in the Indian market a beginning can be made by requiring all companies whose shareholder funds are more than Rs. 100 Crore to compulsorily follow the practice of segment reporting and to extend the requirement to all listed companies over a three year period.

The Study Group also endorses the need for Segment reporting.

SEBI should make it mandatory for companies to disclose details of exports and imports in the annual report. Information should include percentage of exports/imports to total sales/purchases, countries of export/import and currencies to which there is risk exposure.

6.43 Finance

The questions in this section pertain to quality of disclosures in financial statements and of accounting standards. Disclosures in quarterly, half yearly and annual reports, need for disclosure of financial ratios, dividend policy, information on convertibles and suggestions for improvement in financial reporting.

1. The respondents felt that most annual reports do not reflect a true and fair picture of the company and the current disclosure standards range from good to poor with majority of response under adequate.
2. Q. Half yearly reports are generally published by the companies in abridged form. Do you think the information is adequate? If not, what according to you should be the additional disclosure?

Findings

Category Stock Exchange

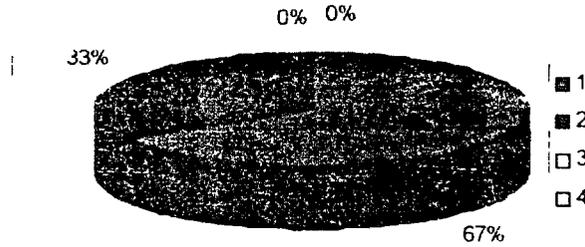


Fig 8 1

Category others

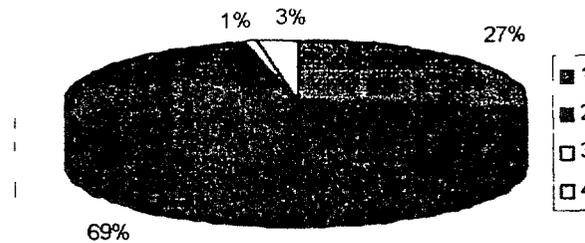


Fig 8 2 2

1 Yes 2 No 3 Conditional Yes 4 No response

Observations

69% of the respondents felt that the information in half yearly report is not adequate. Most of the respondents wanted the Half yearly reports to be audited and in the same format as the annual report.

- 3 Q On a scale of 1-5 (1-Excellent 5-Poor), where do you rank Indian Accounting norms as compared to those of other developed countries?

Observations

The respondents rated the Indian Accounting Standards as good on a scale of 5 ranging from Excellent to Poor

- 4 Majority of respondents viewed changes in accounting policy by companies unfavourably but an equal number were of the opinion that if it is for improving the quality of reporting it is acceptable
- 5 Majority of responses were in the affirmative on the question of desirability of following disclosure
 - In case of change in depreciation policy company should disclose profits based on depreciation calculated as per old method also
 - Current market value of fixed assets to be disclosed to get a better understanding of the asset base of the company
 - In case of change in inventory valuation policy, company should disclose profits based on inventory valuation as per old method also
- 6 Respondents were in favour of analysis of company's performance by its directors especially the non-executive directors. As the directors are required to meet once a quarter such analysis should be made available on a quarterly basis
- 7 The respondents were in favour of companies reporting select financial ratios on an annual basis and they felt that the calculation of these ratios should be standardised. EPS, RONW, DER and Current Ratio were the ratios considered most important
- 8 Q Do you think information provided by a company on convertibles/ warrants etc which result in dilution of equity is adequate? If not what additional information do you require?

Findings

Category Institutional Investors & Opinion Makers

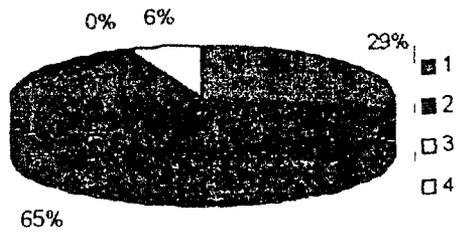


Fig 9 1

1 Yes 2 No 3 Conditional Yes 4 No response

Category Others

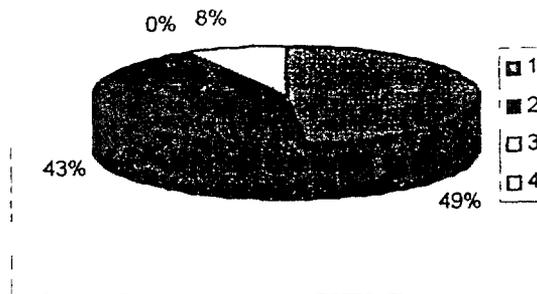


Fig 9 2

1 Yes 2 No 3 Conditional Yes 4 No response

Observations

65% of the Institutional investors and Opinion Makers felt that the information is not adequate Others were equally divided on the issue , perhaps due to their inadequate knowledge on the subject

The following suggestions were made on additional disclosures to be made on convertibles

Full disclosure on shareholding pattern warrants due strike price of warrants options exercised in the case of stock options and impact on EPS Some



respondents wanted disclosure on fully diluted EPS as per International Accounting Standard on EPS

- 9 Respondents were in favour of specific details on 'other income' if it forms significant part of PBT and they favoured such information to be furnished on half-yearly basis
- 10 Other than institutional investors , respondents desired disclosure on measures of volatility of earnings like beta
- 11 Disclosure of dividend policy was considered relevant by retail investors Majority of the respondents were in favour of justification being provided for retention of a portion or all of distributable profits
- 12 Q Are you familiar with International Accounting Standards and Indian Accounting standards Do you find significant gaps between the two? Do you believe that by presenting accounts as per International Accounting Standards and practices, investment decisions can be improved?

Findings

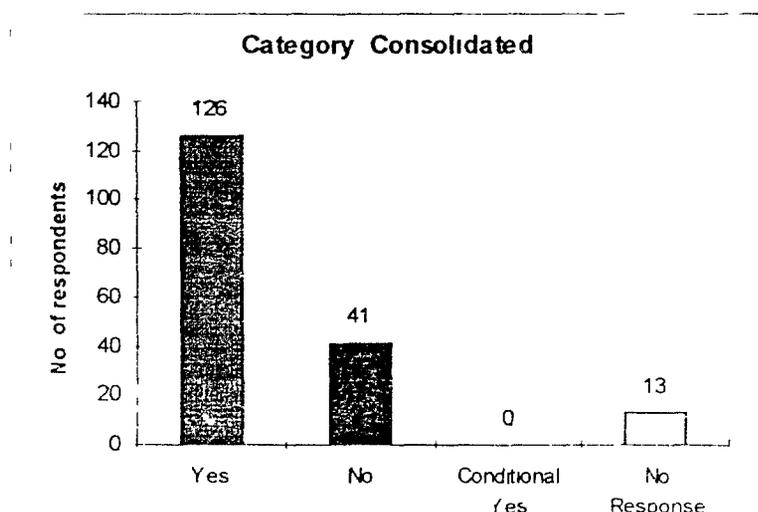


Fig 10

As the familiarity with International Accounting Standards is limited the percentage of 'no' and 'no response' is high as seen in Fig 10. Of those who agreed that there are significant gaps between International and Indian Accounting Standards 80% felt that investment decisions can be improved if accounts are presented as per International Accounting Standards.

13 The following suggestions were made for improvement in financial reporting

- Cash flow statement to be provided on a mandatory basis
- Consolidation of accounts of subsidiaries with the parent company accounts
- Disclosure of contingent liabilities and provisions made for the same
- Reporting should be in line with International Accounting Standards
- Segment Reporting

14 The respondents were unanimous in agreeing that management and auditors should be held liable for misleading financial statements or for negligence in preparing the financial statements.

6.44 Recommendations of the Study Group

It is noted by the Study Group that on recommendations made by Bhavani Committee SEBI has directed Stock exchanges to amend the listing agreement to incorporate the following Disclosures

- Publishing unaudited financial results on a quarterly basis instead of Half yearly basis from June '98 onwards
- Companies mobilising funds from the public to publish details of deployment of funds on half yearly basis instead of yearly basis
- Informing Stock exchanges immediately of all those events that would have a bearing on the performance / operations of company as well as price sensitive information

The Study Group recommends the following with respect to disclosures on quarterly and half yearly basis

- Quarterly / Half yearly reports published in newspapers many a times fail to draw attention of investors. Companies should therefore mail these reports to shareholders on a mandatory basis
- Rating on all fixed income securities issued by a company should be disclosed on a quarterly basis. Changes in ratings and rating agency should be disclosed on occurrence of event. Report on change in rating agency should include reason for the same. If a company obtains multiple ratings, all such ratings should be disclosed
- Half yearly reports should be audited and drawn up in the same format as Annual Report
- Notes to summary of results published on a quarterly basis should include explanations about significant deviations from performance during the previous period for which comparative figures are disclosed. It should also include past trend by way of percentage of revenues of each quarter in the previous year to total revenues for the year
- Penalties if any imposed by regulatory authorities for non-compliance or violation of norms should be disclosed on a quarterly basis
- Quarterly Report on shares of the company dealt with during the quarter along with dates and the names of employees or connected persons

The Study Group recommends that the following additional disclosures be made mandatory in Annual reports

1. *Additional disclosures on convertibles, warrants, etc.*

- Fully diluted EPS as per International Accounting Standard
- Shareholding pattern post conversion

- options exercised in the case of stock options
 - Due dates of conversion
- 2 Management analysis of the financial statements using key ratios such as Earnings Per Share (EPS) Return On Networth (RONW) Debt Equity Ratio (DER) and Current ratio It should also include comments on cash flow statement

The Study Group notes that gap between International and Indian accounting Standards will be significantly reduced if 'Bhave Committee' recommendations on Consolidation of Accounts Segment reporting and Deferred Tax liability are implemented after ICAI draws up Accounting Standards for the same

6.45 Projections

Questions under this section were intended to have the views of respondents on the importance of furnishing projections in Offer documents and other reports

The Study Group notes that 'Malegham Committee' (on disclosure requirements in Offer Document) had placed a number of restrictions / conditions on disclosure of projections in Offer Document as they can be a source of misinformation and are often grossly optimistic some of the conditions being projections should not be for more than two years and should be based on appraisal made by a Financial Institution or Bank or Lead Manager

- 1 Q Should projections be part of Annual report? Should regulatory authority prescribe a format for giving projections? Which is the appropriate document and time period for making the projections?

Findings

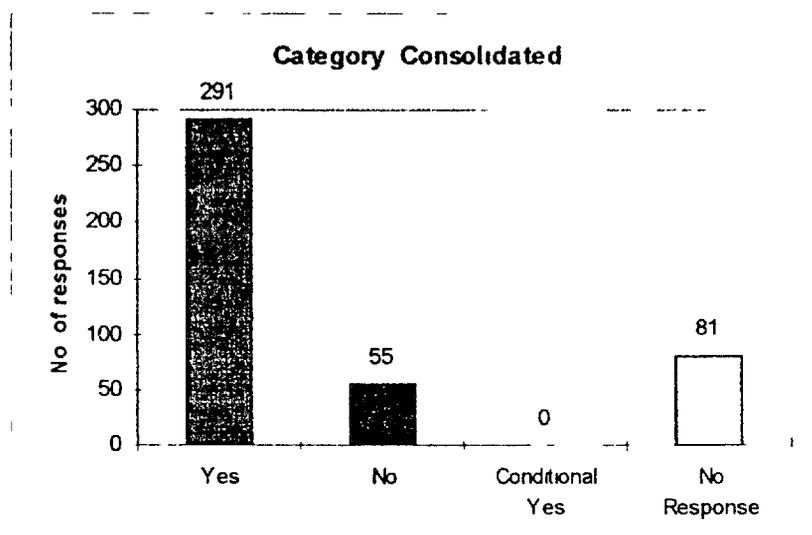


Fig 11

291 respondents, constituting 68%, felt that projections should form a part of Annual report/ Offer Document as seen in Fig 11. They also feel that it would be helpful if companies give basis for their projections along with explanatory notes. Majority of the respondents were also of the view that management should be held accountable for their projections, to the extent deviations are due to internal factors.

2. Majority of respondents are in favour of projections being made using both expected values and optimistic & pessimistic values.
3. Respondents of all categories favouring projections, favoured projections for three years in Offer document and projections for one year in Annual report.
4. Opinion was divided on whether the financial institution making the projections should participate in the equity of the project. However, those who were in favour clearly wanted lock-in for such participation and lock-in for three years being the reasonable time for project implementation.

85

6 46 Recommendations of the Study Group

The Study Group is of the view that projections can be misleading and hence a possible source of misinformation and consequent unwarranted litigation. Management should not therefore be required to provide projections. Rather they should provide information that helps users to forecast for themselves the company's future performance. Contrary to majority opinion which favours projections in annual report in addition to Offer document the Study Group recommends that management should only provide forward looking information on

- Opportunities and risks
- Management's plans including critical success factors
- Comparison of actual performance with previously disclosed opportunities risks and plans

6 47 Off balance sheet items

The questions under this section sought views of respondents on the need for disclosures regarding contingent liabilities leased assets hedging instruments use of derivative instruments and attendant risks and accounting for forward foreign exchange contracts

- 1 Majority of the respondents were of the view that companies do not disclose contingent liabilities in a proper manner nor do they make adequate provisions for them
- 2 Most of them were in favour of proper disclosure of leased assets and of hedging instruments
- 3 Majority were favouring revaluation of forward foreign exchange contracts on balance sheet dates and transfer of gain/loss arising therefrom to profit & loss account

6.48 Recommendations of the Study Group

The Study Group recommends the following additional disclosures to be made on a mandatory basis about the identity, financial impact, risks and obligations resulting from the following Off balance sheet items:

- Contingent Liabilities
- Leased Assets
- Financial instruments in the nature of off balance sheet items

6.49 Risks

The questions under risk pertained to nature of risks to be disclosed, risk analysis framework and feasibility of developing a composite risk index.

1. Q. Do you think a risk management framework be undertaken by a company and disclosed in the Annual Report?

Findings

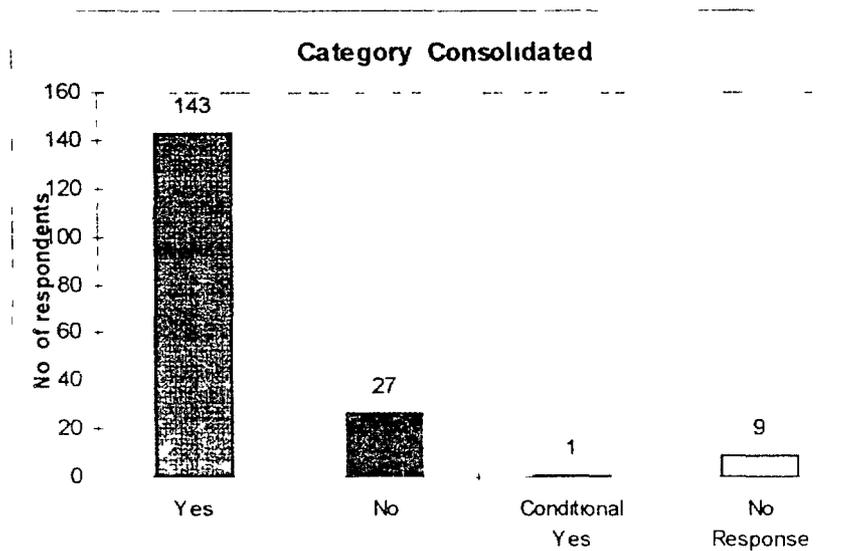


Fig 12

87

Observations

143 respondents constituting 80% were of the view that the companies should undertake a risk management framework and disclose the same in the Annual report. It should include mainly business risk and financial risk. There was mixed opinion on whether the framework should be standardised. Most of those who favoured a standard framework required the same to be based on performance parameters whereas the others felt that policy and performance should be considered.

2. 59% of the respondents were in favour of the company providing forward looking information on expectations about performance vis-a-vis international competitors. The 'no response' to this question was high at 32%.

3. Q Do you think it is feasible to develop a composite risk index for a company?

Findings

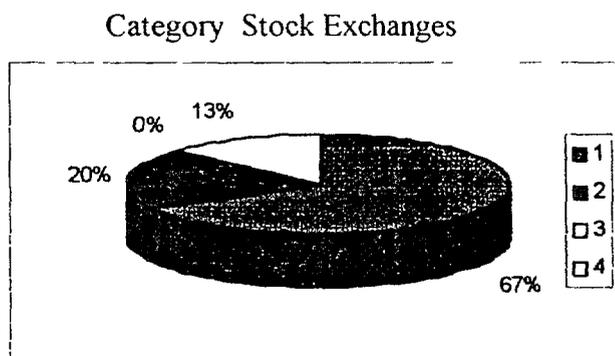


Fig 13.1

1 Yes 2 No 3 Conditional Yes 4 No response

98

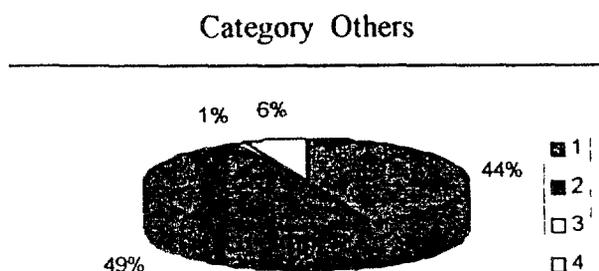


Fig 13.2

1 Yes 2 No 3 Conditional Yes 4 No response

Regarding the feasibility of developing a composite risk index, 67% of Stock exchanges felt that it is feasible whereas majority of respondents in other categories were of the opinion that is not feasible

6.4.10 Recommendations of the Study Group

The Study Group notes that the disclosure regarding risks to which the Companies and investors are exposed are grossly inadequate in Offer Document and absent in Annual reports. The general response under ‘ Management perception ’ to most of the risk factors disclosed in offer documents is stated as follows

‘The risks are inherent in the business. The company has put in place adequate risk control measures to manage these risks’. This reply does not educate the investor on the level of risk exposure faced by him or her

It is therefore suggested that a risk management framework should be developed and disclosed by issuers covering major internal and external risks such as business risk, financial risk, interest rate risk and foreign exchange risk. The framework can include both policy and performance parameters

49

6 411 Bankers

While 70 % of respondents were in favour of disclosing the names of bankers a substantial 28% felt that the information was not relevant

6 412 Rating

Questions on rating related to importance of rating for investment decisions instruments for which rating is desired disclosure of existing ratings and changes in ratings from all rating agencies

- 1 Majority of the institutional investors felt that rating is not very important as it is not a lead indicator most of the time The retail investors and stock brokers on the other hand rated the importance between 3 and 5 on a scale where 1 implies least important and 5 implies very important
- 2 Majority felt that rating should be for fixed income securities and if feasible for the management and the entire company The Stock Brokers and Retail Investors felt that rating should be provided for Equity also
- 3 The respondents were near unanimous that companies should obtain rating from one agency consistently and should not switch rating agencies In case of change in rating agency the reasons for the same should be properly disclosed
- 4 The companies should report on a quarterly basis, ratings obtained on all its fixed income securities The respondents also felt that the onus of continuous monitoring and disclosure of ratings/changes in ratings should be on the rating agency rather than the company
- 5 It was suggested that the rating agency should publish information on all ratings on a monthly basis (change of ratings should be published immediately)

6 A number of respondents doubted the credibility of the rating agencies

6 413 Recommendations of the Study Group

- Rating on all fixed income securities issued by a company should be disclosed on a quarterly basis changes in ratings and rating agency should be disclosed on occurrence of event Report on change in rating agency should include reason for the same If a company obtains multiple ratings all such ratings should be disclosed

6 414 Legal Compliance and Investor Protection

The questions in this section deal with reportings relating to compliance need for a compliance officer official spokesperson and compliance audit and disclosures relating to investor complaints

- 1 Most of the respondents wanted companies to furnish information to investors regarding non-compliance with various statutory norms and regulations but some commented that the companies would be reluctant to make any disclosures in this regard
- 2 Similarly while majority of respondents wanted information on charges against the company by Govt officials and charges against promoters/top management to be communicated to the investors some of them reasoned that companies will not furnish the same as it would put them in bad light Instead, the regulatory authority should periodically disseminate such information The Study Group concurs with this view

- 3 89% of the respondents were in favour of details of investor complaints to be published. Majority were in favour of the details to be furnished on a mandatory basis in the Annual Report. About 25% were in favour of the disclosure on quarterly basis. The respondents required disclosure of broad category of complaints together with the corresponding numbers. There were suggestions that instead of absolute numbers, number of complaints as a percentage of number of shareholders would be more useful.
- 4 The idea of a company engaging the services of a compliance officer was welcomed by most of the respondents and some felt that the Company Secretary himself can play the role.
- 5 The respondents felt that the official spokesperson should have the authority to give required information about the company and he should be held accountable for the statements made by him. The retail investors felt that all the market players, namely institutional investors, FIIs, brokers and retail investors should get the same amount of information from the same source.
- 6 As regards Compliance Audit as is done in the developed markets, it was felt that no useful purpose would be served and it would be one more regulation formality to be complied with.

6.4.15 Recommendations of the Study Group

SEBI should periodically publish/ widely disseminate information to investors on details of non-compliance as also details of charges against the company, its promoters and top management on material issues. It is felt that such publicity would act as a strong deterrent to violation of norms by companies.

Disclosure on investor complaints on an annual basis should be made mandatory. The company should give details of number of complaints received, settled, pending for more than 30 days, nature of complaints and number of complaints received as a percentage of number of shareholders.

1 Group companies and subsidiaries

Questions under this section related to need for consolidation of accounts and sought views of respondents on the practice of lending to group companies.

78% of the respondents were of the opinion that Indian Accounting Standards should provide for consolidation of accounts and information provided about the subsidiaries should include financial statements, nature of business and shareholding pattern.

- 2 On the question of whether lending to group companies should be allowed, 53% said no and 40% said yes. Of those who said yes, 64% felt that there should be total restriction of the same. On a separate question on whether companies should be allowed to lend to group companies provided they meet certain norms, 64% said yes.

Based on additional qualitative responses received, the Study Group observes that the respondents were in favour of lending to group companies provided the transactions are at arms' length, interest is levied at market rate and there is a ceiling on amounts lent.

6.416 Recommendations of the Study Group

The Study Group notes that the Bhave Committee has already made its recommendations to SEBI on consolidation of accounts and it reiterates the importance of the same.

- The Study Group recommends that pending a guideline/standard on consolidation of accounts as recommended by Bhave Committee it should be made mandatory for companies to value investments as per equity method
- Such additional disclosure be made by companies which would enable investors to decide whether the transactions are at arms length and at market determined terms

6 417 Properties

- 1 Questions under this section were on desirability of disclosing information about the immovable properties of the company
- 2 80% of the respondents wanted information on immovable property to be disclosed Market value and strategic importance were the essential items details of which were sought to be disclosed

6 418 Personnel & HR

Questions under this section related to desirability of information on board of directors and top management relating to their compensation experience etc

- 1 85 % of the respondents favoured disclosure on details about Board of Directors/Top management While opinion was divided on whether the criteria for deciding about 'top management' should be compensation or hierarchy, there was consensus that information should be given for top 10 Information to be furnished should include qualifications past experience track-record in previous employment salary and nature of employment
- 2 Majority of respondents felt that disclosures on non-cash compensation to management are not adequate

- 3 As regards information being provided in the Directors' Report on employees drawing remuneration of not less than Rs 25 000/- most of the respondents felt that such information is not very relevant and should be provided only for key employees

6.4.19 Corporate Governance

Questions under this section related to investor preferences for types of organisation and mechanism to prevent insider trading. The respondents were required to name five companies who follow greater disclosure standards voluntarily and five companies whose disclosure standards are below those required under Indian law and regulations.

- 1 Institutional investors did not distinguish between family owned businesses and professional organisations. Investment decisions were based purely on performance. A minority of the retail investors preferred family owned businesses like Tatas, Birlas and Ambanis.
- 2 Many of the investors felt that it is very difficult to prevent insider trading. A few suggestions which came up to curb insider trading were
- Filing of periodic ownership reports by key employees
 - Companies to develop in-house protocol to prevent insider trading
- 3 Views of respondents on companies whose disclosure standards are higher and lower respectively than what is required under Indian Law and Regulations.
- 4 The following table gives a list of the above categories of companies named by respondents. Only those companies named by at least 5 respondents have been included.

Table I

Category I (Companies whose disclosure standards are higher)

<i>Name of the company</i>	<i>No of respondents who have named the company</i>
Infosys	59
HLL	48
Reliance Industries Ltd	25
TISCO	15
HDFC	8
TELCO	11
Colgate Palmolive	5

Table II

Category II (Companies whose disclosure standards are lower)

<i>Name of the company</i>	<i>No of respondents who have named the company</i>
RPG Group	5
Jindal Group	5
Essar Group	5
Modi Group	5
Ispat Group	5

- 5 Respondents were generally reluctant to name companies in the second category. Either the question was left unanswered or the reply was vague like 'there are too many to be named' or 'all NBFCs'. Some respondents stated that they would not like to name them.

6.420 Recommendations of the Study Group

Insider trading affects the integrity and fairness of the securities market. The use of price sensitive information by the investors for profit reduces the overall investor confidence in market. While it is extremely difficult to pin down insider trading, the only effective way to curb the same is by companies adopting an internal code of conduct. Companies like Infosys have well laid down codes and have set up blind trusts for purchase and sales of the company's shares by their top executives.

The Study Group recommends that Share Ownership reporting and reporting of movement of shareholding by directors and officers who have substantial managerial powers of a company should be made mandatory. This will allow the market to track insider trading and thus prevent the practice. As of now, SFBI takes up investigation post event of instances of insider trading brought to its notice. This does not protect the interest of genuine investors. Further, auditors should be precluded from holding shares of the companies whose accounts are audited by them.

The Study Group also recommends that SEBI should make it mandatory for all listed companies to adopt a Code of Conduct for prevention of insider trading which should cover the following salient points:

- Persons to whom the rules under the Code of Conduct would be applicable
- Definitions of 'Insider', 'unpublished price sensitive information' and 'dealing in shares'
- Prohibition on dealing, communicating or counseling
- Procedure for dealing in the shares of the company by
 - Employees and Senior Management
- Prohibition for dealing in shares before and after the end of a quarter and before and after a Board meeting
- Report to Board of Directors of the Company and SFBI
- Penalty for violation

The CEO of the company should report compliance with the code of conduct to the company's Board of Directors on a half yearly basis

6.421 Views of Retail Investors

1. The retail investors are of the strong view that the market is at the mercy of institutional investors and loaded against small investors. With the FII's driving the market there is extreme volatility resulting in the small investors getting their fingers burnt. They also expressed the anguish that they have no access to corporate information and in many cases not even annual reports and commented bitterly that even if they do get some information they have no faith in that information. Awareness of investors rights and protective measures is almost nil. There is urgent need for SEBI to put in place a redressal system for investor grievances which is expeditious, fair and infuses confidence in regulatory authority.

6.422 Recommendations of the Study Group

Measures should be taken to increase awareness of investors rights through investor education programs organised by Stock Exchanges, Investor Associations or such other organisations. SEBI should be armed with adequate powers to enforce restoration to investors of moneys taken from them in violation of regulation, to impose fines, initiate criminal action and set up mechanism for quick redressal. This may be enabled if SEBI is vested with the powers of a civil court under Code of Civil Procedures.

Disparity of dissemination of information to Institutional Investors and Retail Investors is wide. A centralised information depository if set up should not allow such disparities to exist.

India is perhaps the only country where new firms without track record can access public funds and get listed on major Stock Exchanges. The problem faced by individual investor in evaluating investment in such firms can be overcome if they are allowed to list only on the OTCEI. Venture capital funds which aim to invest primarily in start up firms must also be encouraged.

6.423 Feasibility of Stock Exchanges playing the lead role in dissemination of information to investors.

1 Observations

The Stock Exchanges agree that they should play the lead role and should provide Public Reference Facility. Most of them however presently lack the required infrastructure in terms of systems, processes and skilled personnel to collect, process, store, retrieve and disseminate information on issuers. While the Exchanges have not given the cost of providing such facility, all of them have said that the listing fees is adequate to cover their costs.

6.424 Recommendations of the Study Group

Investor participation has so far been mainly restricted to urban areas. With 23 Stock Exchanges covering all of them, it is possible to disseminate information effectively through these Stock Exchanges provided there is well equipped Public Reference Facility. The Study Group recommends that SEBI should issue detailed guidelines to all Stock Exchanges on the minimum requirements to be met in setting up (on a mandatory basis) a Public Reference Facility. It should have adequate number of computer terminals to enable investors to have easy access to information on the internet.

7 OBSERVATIONS FROM CASE STUDIES

The detailed case studies are presented in Appendix IV. A summary of findings is given below.

1. Companies display the tendency to shout good news and suppress bad news. When performance is good, detailed commentaries form part of Directors' report, comparing performance with previous years, including graphic presentations of the positive trend. Such disclosures are reduced to minimum when performance is adversely affected.
2. Some companies, particularly the larger ones, are already providing information that substantially meets the requirements of various end users. Majority of the companies, however, provide the bare minimum information as required by the Companies Act and Listing Agreement.
3. Those companies which are providing a lot of additional information are doing so in a variety of ways, thus making comparisons difficult.
4. A number of companies have subsidiaries engaged in unrelated lines of business. Many have subsidiaries which are investment companies. However, no justification is offered to the shareholders of the parent company. Where loans and advances have been extended to loss-making subsidiaries, no provision has been made by some companies.
5. There are no shareholder communications by most companies other than periodical financial statements and notices of AGM and EGM.
6. Even the multinational companies desist from reporting as per US GAAP as they can project performance in a better light if they follow Indian GAAP, as substantiated in the case studies. The only exception observed by us was Colgate Palmolive Co Ltd, following deferred tax accounting, which is not mandatory as per Indian GAAP.
7. No distinction can be made in the level of disclosures between companies which have tapped international capital markets by issuing GDRs and companies which have not.

- 8 While rigorous statistical analysis has not been done a comparison of stock returns of companies selected for case study against return on BSE indicates that market does reward transparency
- 9 Poor disclosures are generally made by companies whose business practices are questionable. Good disclosures reflect high level of corporate performance

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Current Disclosure Practices/ Bhav Committee Recommendations/ Investors Needs As Per The Survey

<i>Current disclosure requirements</i>	<i>Bhave Committee Recommendations</i>	<i>Investor needs as per Survey/Case Study findings</i>
Consolidation of subsidiaries is not required	Consolidation be made mandatory for companies defined as holding companies under the Companies Act 1956	Consolidation of subsidiaries accounts required
Depreciation is on SLM/WDV method Asset life is derived from the depreciation value Excess depreciation is allowed	Nil	If there is a change in depreciation method, companies should disclose profits based on depreciation calculated as per old method also
No distinction between fixed and current assets investments. All investments are carried at cost, but market value is disclosed. And provision is made for diminution in value	Nil	Many companies do not provide for diminution in value stating that the diminution is on account of short term volatility
Capitalization of lease is not required Operating and finance lease rentals are recognized in the profit and loss account	Nil	Investors require disclosure on details of leased assets not appearing in balance sheet
Taxation is provided on estimated tax liability currently payable and no deferred taxation is required	Deferred tax accounting using the liability method in line with IAS should be made mandatory. In the interim period the listed companies may be asked to provide a reconciliation statement explaining the differences between the taxable profits and the book profits in a summarized manner.	Companies should follow deferred tax accounting
R & D expenditure is charged to P & L account except equipment & machinery which are capitalized	Nil	Considering that the R & D expenditure by Indian companies are insignificant with the exception of some industries like pharmaceuticals information on R & D expenditure was not found to be required

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<i>Current disclosure requirements</i>	<i>Bhave Committee Recommendations</i>	<i>Investor needs as per Survey/Case Study findings</i>
Information on EPS is not required to be disclosed		Disclosure on EPS required in case of convertibles warrants stock options etc addition of disclosures required including Fully Diluted EPS as per International Accounting Standard
Amounts outstanding at the year end in respect of certain related party transactions are disclosed		
Extraordinary items are reported without tax effect	Quantification of financial information given in notes and classifying the information in notes as those having material effect on the reported earnings and reserves	Issue not addressed by the Survey
Changes in accounting policies and prior year's items are reported in the year of change	Effect of changes in accounting policies on the earlier account periods should be drawn up and presented in the financial statements	Changes in accounting policies were viewed unfavourably by most of the respondents. However some felt that if it is to improve the quality of reporting then it is OK.
Disclosure need not be made for segments of the business beyond the disclosure of turnover and inventory for different classes of goods	Segment wise information of sales assets and net income before interest and tax to be provided by companies with turnover above Rs 100 Cr to begin with and to be extended to all listed companies over a period of three years	The respondents were strongly in favour of segment reporting
	Where the auditor's report contains any qualification regarding the manner in which profits losses assets liabilities are accounted the same should be taken into account in the determination of divisible profits	Issue not addressed by the survey

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<i>Current disclosure requirements</i>	<i>Bhave Committee Recommendations</i>	<i>Investor needs as per Survey/Case Study findings</i>
	Presentation standards be prescribed by ICAI	Lack of standardisation makes comparison of disclosure practices by different companies difficult as found during the case analysis
	Quarterly disclosures of unaudited results be made mandatory and these should be on the same set of accounting policies as those of the previous year	Quarterly results required as per survey findings
	Audited results with changes in accounting policies when sent to the stock exchange should have the following results comparable to the previous year's results on no accounting policy change results based on changed accounting policies	Issue not addressed by the survey
	Any material event which is likely to affect a company's performance should be intimated within 48 hours to the exchanges	Events such as change in ownership takeover merger or acquisition change in key management personnel major expansion plans were required to be reported on occurrence of event
Note	Issues not addressed by Bhave Committee and not forming part of current disclosure requirements but dealt with in the survey findings are not presented in this table	

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9 STUDY GROUP RECOMMENDATIONS

a) Improvement in information dissemination

The Study Group recommends setting up of Information Depositories at two levels - In SEBI at the national level and in stock exchanges at the regional level. Issuers should be required to file reportings with SEBI and the stock exchanges where the shares are listed. These should be reviewed, monitored, checked for accuracy and consistency by trained professionals to be employed/outsourced by them. SEBI and stock exchanges should be responsible for prompt dissemination of material / price sensitive information received by them.

SEBI should issue guidelines to all stock exchanges for setting up of a Public Reference Facility on a mandatory basis.

At present there seems to be a wide disparity in dissemination of information to different categories of end users. One of the effective ways in which information can be disseminated quickly and in a cost effective manner is through the net. SEBI and the stock exchanges should have a home page on the internet to which all filings can be posted. For this purpose, companies should be required to submit their filings in electronic form. The Public Reference Facility to be set up in stock exchanges should have adequate number of computer terminals to enable investors to have easy access to information on the internet.

Share Ownership reporting and reporting of movement of shareholding by directors and officers who have substantial managerial powers of a company, should be made mandatory. This will allow the market to track insider trading and thus prevent the practice. As of now, SEBI takes up investigation post event, of instances of insider trading brought to its notice. This does not protect the interest of genuine investors. Further, auditors should be precluded from holding shares of the companies whose accounts are audited by them. SEBI should make it mandatory

for all listed companies to adopt a Code of Conduct for prevention of insider trading which should cover the following

- Persons to whom the rules under the Code of Conduct would be applicable
- Definitions of 'Insider', 'unpublished price sensitive information' and 'dealing in shares'
- Prohibition on dealing, communicating or counseling
- Procedure for dealing in the shares of the company by
 - employees
 - senior management
- Prohibition for dealing in shares before and after the end of a quarter and before and after a Board meeting
- Report to Board of Directors of the Company and SEBI
- Penalty for violation

The CEO of the company should report compliance with the code of conduct, to the company's Board of Directors on a half yearly basis

b Further improvements in disclosures

1 Disclosures in Annual Reports - Mandatory

- The annual report should include a historical background of the company and its business in order to improve the understanding of the financial statements. Besides the scope and description of business, it should include vision statement, broad objectives and strategies, what management believes to be the core business and impact of industry structure on the company
- Historical data for the last five years should be given to enable analyzing of trends and relationships to predict future earnings. It should segregate core and non-core activities, as it is the company's core activities (usual and recurring events) which provide the relevant information from which predictions can be made about the future

- Balance sheet should be reformatted to disclose assets and liabilities in order of liquidity Current liabilities should be disclosed separately
- Profit and loss account should be reformatted to disclose gross profit.
- The following additional disclosures should be made on convertibles, warrants and stock options
 - Fully diluted EPS as per International Accounting Standard
 - Shareholding pattern post conversion
 - Due dates of conversion
 - Options exercised in the case of stock options
- Following details about exports and imports should be given
 - Percentage to total sales / purchases
 - Countries of export/import
 - Currencies to which there is risk exposure
- Off balance sheet items- Adequate disclosures should be made about the identity, financial impact, risks and obligations resulting from the following off balance sheet items
 - Leased assets
 - Contingent liabilities
 - Financial instruments in the nature of off balance sheet items
- Management analysis of the financial and non-financial data giving explanations for changes in operating, financing and performance related data , analysis of financial statements should use key ratios such as Earnings Per Share, Return On Networth, Debt Equity Ratio and Current ratio It should also include comments on cash flow statement
- Share performance - A graph to be included showing share price movements during the reporting period against BSE or any other suitable index It should also disclose volumes of trading
- Following details of investor complaints should be included
 - Number of complaints received during the reporting period
 - Number of complaints settled

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- Number of complaints pending for more than 30 days
- Number of complaints received as a percentage of number of shareholders
- Nature of complaints
- Significant changes, additions and deletions to disclosures as compared to previous Annual Report.

The following are the other suggestions relating to disclosures in Annual Report

- Transactions among related groups/companies should be clearly disclosed for investors to understand if they were conducted at arm's length
- Proper justification should be given for investments in subsidiaries especially if they are in unrelated lines of business. Management should clearly explain benefit to shareholders of parent company. Pending a guideline/standard on consolidation of accounts as recommended by Bhave Committee, it should be made mandatory for companies to value investments as per equity method
- Companies should be required to make full provision for loans and advances which are doubtful of recovery and are unsecured. Further, companies should be required to account for interest on such loans and advances on cash basis. Companies should be required to follow the Reserve Bank of India guidelines to banks for asset classification, income recognition and provisioning under Prudential Norms

2. Disclosures in Annual Reports - Optional

- Forward looking information which would help users to forecast for themselves the company's financial future. It can include
 - Opportunities and risks
 - Management's plans

- Critical Success Factors
- Comparison of actual performance with previously disclosed opportunities, risks and plans
- A risk management framework may be developed and disclosed covering major internal and external risks such as business risk, financial risk, interest rate risk and foreign exchange risk. The framework can include both policy and performance parameters
- Information on high and low of share price during the reporting period

3 Disclosures in Quarterly/Half yearly and other reports

- Quarterly / Half yearly reports published in newspapers many a times fail to draw attention of investors. Companies should therefore mail these reports to shareholders on a mandatory basis
- Rating on all fixed income securities issued by a company should be disclosed on a quarterly basis, changes in ratings and rating agency should be disclosed on occurrence of event. Report on change in rating agency should include reason for the same. If a company obtains multiple ratings, all such ratings should be disclosed
- Half yearly reports should be audited and drawn up in the same format as Annual Report
- Notes to summary of results published on a quarterly basis should include explanations about significant deviations from performance during the previous period for which comparative figures are disclosed. It should also include past

trend by way of percentage of revenues of each quarter in the previous year to total revenues for the year

- Penalties if any, imposed by regulatory authorities for non-compliance or violation of norms should be disclosed on a quarterly basis

c) Improvements in enforcement mechanism

1 The regulation of the securities market should be entrusted to a single, highly visible authority which can function independently, with a strong statutory backing. Above all, it should win the confidence of investors. Towards this end, SEBI should take the following steps, preparatory to improving disclosures

- SEBI should take up studies to find out the present status and whereabouts of the projects and promoters of around 4000 public issues made during April 1992 and March 1996, identify the fly-by-night operators from among them and take exemplary punitive action against them. Punishment should include impounding of issue proceeds from the promoters and refunding the same to the investors

- Following alternatives can be considered to weed out the numerous illiquid scrips listed on the stock exchanges

a) Permit promoters to buy back the shares

b) Before delisting the scrips, make it mandatory for the promoters and merchant bankers to make an open offer to all the investors to purchase the shares at a determined price

2 SEBI should tighten the norms for new issues. Companies with no track record should be allowed to list only on the OTCEI. Venture capital firms which aim to invest primarily in start-up firms should be encouraged

- 3 SEBI should periodically publish/widely disseminate information to investors on details of non-compliance by listed companies. Such publicity would act as a strong deterrent to violation of norms by issuers.
- 4 SEBI should draw up penalty structure for different categories of non-compliance and enforce the same quickly and meticulously. For this to be effective, SEBI should be armed with adequate powers not only to impose fines but also to restore moneys to investors taken in violation of regulations, to initiate criminal action and to have a mechanism for quick redressal of investor grievances. This may be enabled if SEBI is vested with the powers of a civil court under Code of Civil Procedures.