

Governance Insight

Emphasising corporate governance disclosures by boards

November 2020

Volume I



One of the key functions of the board is overseeing the process of disclosure and communications. The board is required to ensure all material information is subject to timely disclosures. Inadequate, misleading, or delayed disclosures may invite regulatory action from the Ministry of Corporate Affairs (MCA), stock exchanges and Securities and Exchange Board of India (SEBI).

Corporate governance is a critical success factor for a company and a key requisite to create a culture of transparency, accountability and disclosure. The corporate governance practices of Indian companies, especially listed ones, are driven by a combination of mandatory requirements, voluntary guidelines and market forces. National Guidelines on Responsible Business Conduct (NGRBC) released by the MCA in 2019 are designed to assist businesses to embrace the principle of responsible conduct and to take on leadership roles in practices and disclosures. Under the NGRBC, Business Responsibility and Sustainability Report (BRSR) is being stressed upon to reflect the intent and scope of reporting requirements and go beyond the regulatory financial compliance and report on the social and environmental impacts as well.

Thus, the boards are expected to ensure compliance with the legal framework, integrity of financial accounting and reporting systems as well as credibility in the eyes of the stakeholders through timely disclosures. The governance regulations that are unique in the legal framework, include mandatory requirement of board evaluation, rotation of auditors, mandatory corporate social responsibility (CSR) spend, one female independent director and disclosure of dividend distribution policy by the top 500 companies.

Mandatory disclosures



Board report includes director's responsibility statement, including proper systems to ensure compliance with all applicable laws



Annual report includes financial statements, related party disclosure, management discussion analysis



Corporate governance report is a section of the annual report and includes disclosure of relationships between directors, among others



Other disclosures, such as **details of establishment of Vigil mechanism, whistle-blower policy and affirmation** that no personnel have been denied access to the audit committee

- web link where policy on determining 'material' subsidiaries is disclosed
- web link where policy on dealing with related party transactions is disclosed

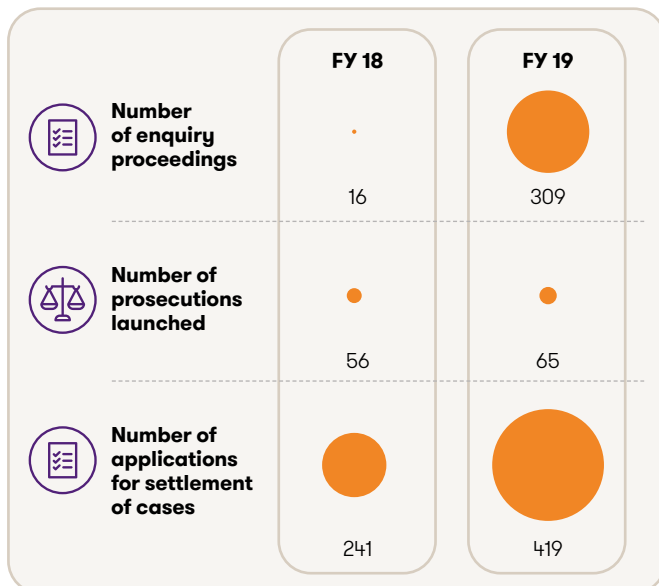
Contact information of designated officials responsible for assisting and handling investors grievances

Tighter disclosure regime

With increased shareholder activism and elaborated compliances, companies have faced allegations of lapse in corporate governance practices. In addition to board governance and executive compensation, violation of related party transactions norms, inadequate financial reporting and misutilisation of assets, including diversion of funds for non-core business purposes have been the emergent issues in corporate governance of India Inc. Moreover, illegal fund mobilisation in violation of the Companies Act 2013 has topped the list of the nature of violations in the prosecution launched by SEBI as revealed in the regulator's annual report of FY 19. As many as 47 out of the total 65 violations mentioned were pertaining to illegal fund mobilisation.

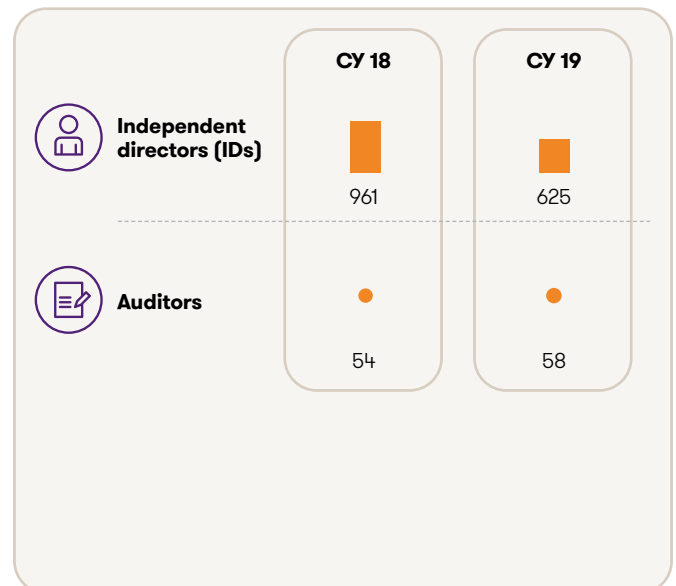
Moreover, recent decisions of the Supreme Court have driven adoption of strong governance protocols, including freezing of personal assets of independent directors (IDs) for defaults by the companies. As part of duties of IDs, under Schedule IV of the Companies Act 2013, they shall not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the board or required by law. Consequently, the number of exits of IDs from the boards of Indian companies increased 54% year-on-year in calendar year (CY) 2019.

Data on regulatory action by SEBI



Source- SEBI Annual Reports

Mid-term exits from listed Indian companies



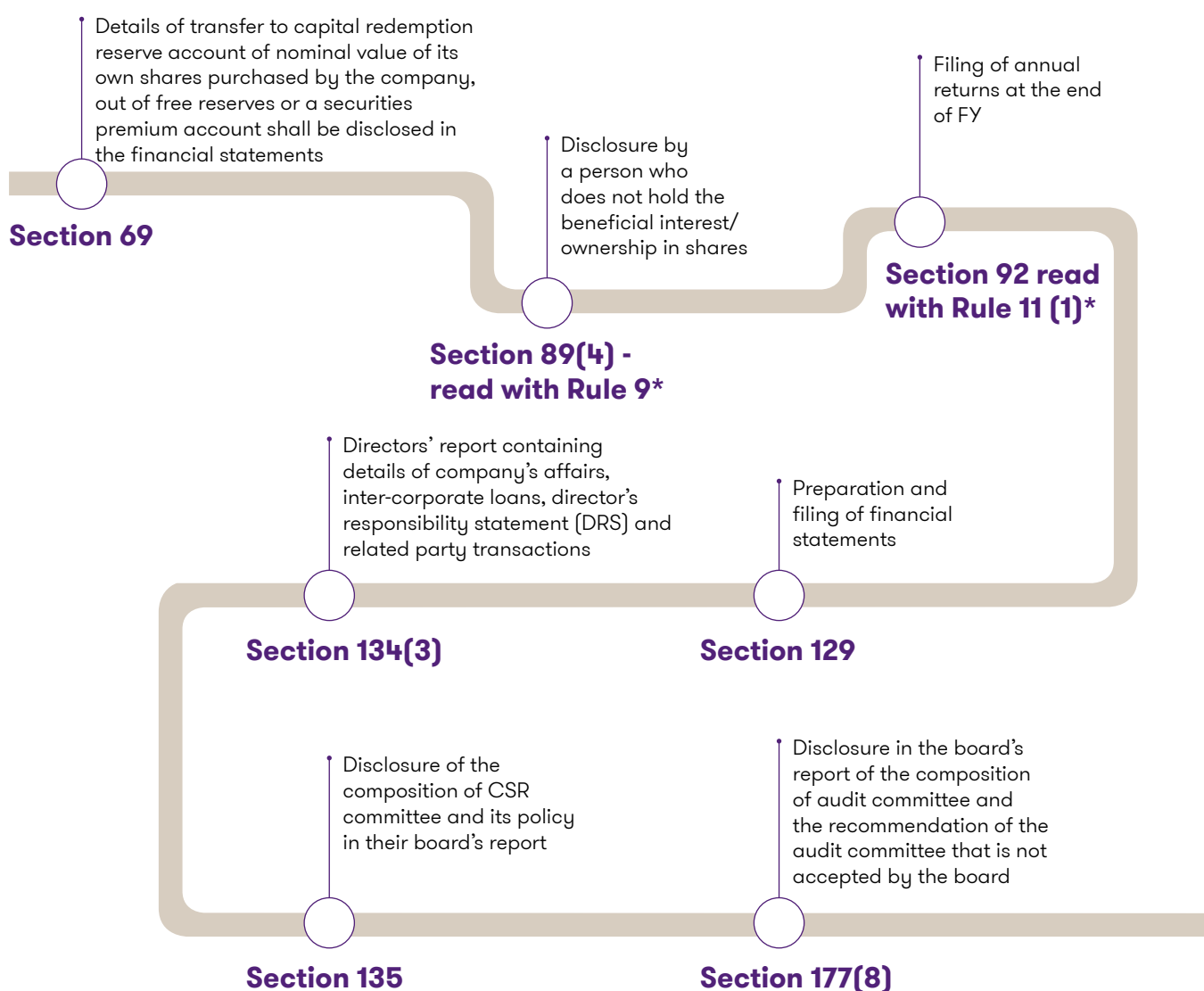
Source: NSE

In addition, the loan defaults in Indian companies and the setting up of Insolvency and Bankruptcy Code (IBC), which now holds almost USD 20 billion in debt, as per the IBC, has increased questions around asset quality. Amidst this are the economic growth concerns that are now sounding a much-needed wake-up call to look at corporate governance more seriously.

Good practices for compliance

With applicable code on corporate governance, as formulated and adhered by the boards, enterprises should follow a 'comply or explain' rule where they disclose the extent of followed code's recommendations and explain any deviations

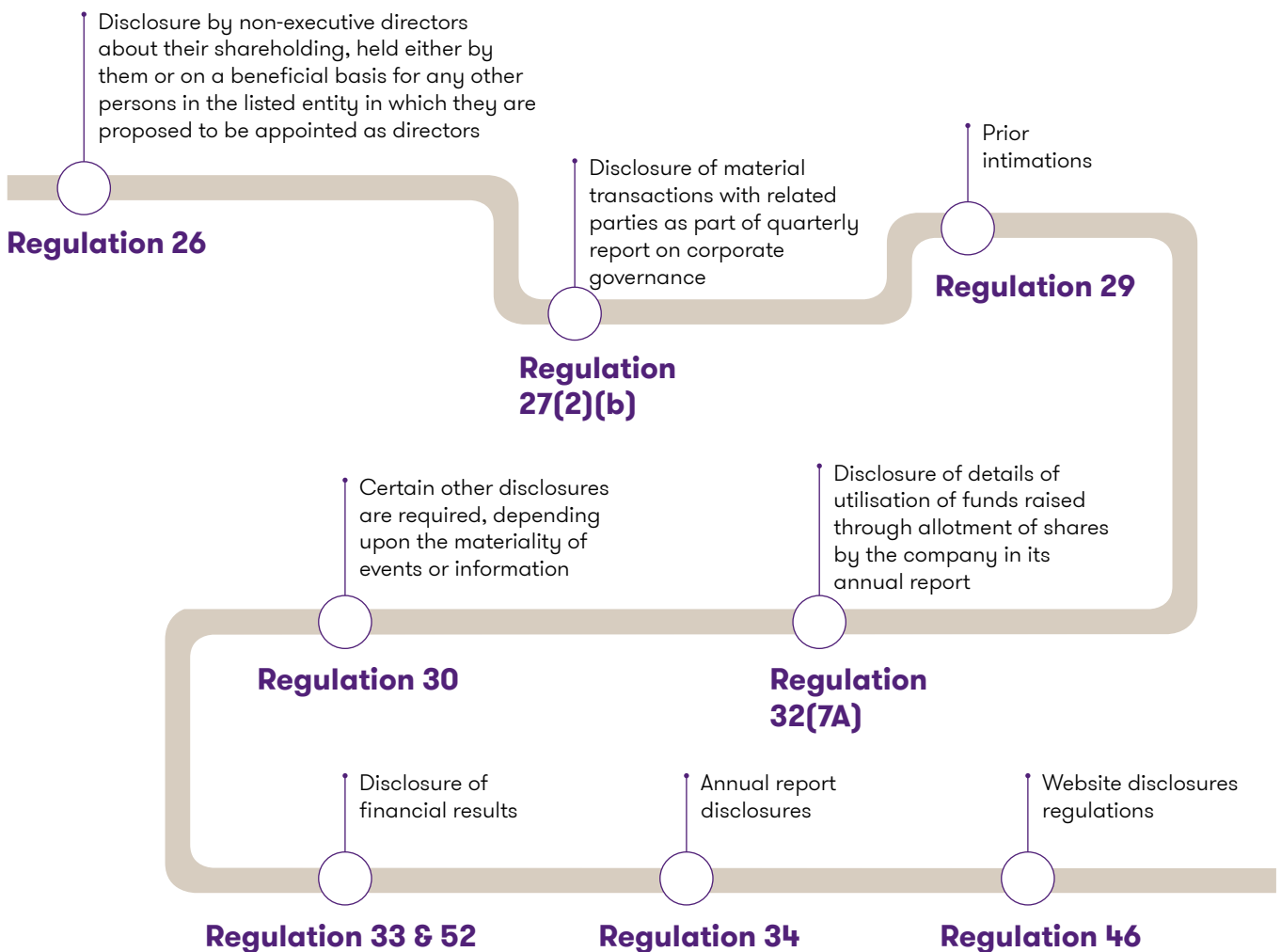
Disclosures required to be made by a company and its boards under various sections of the **Companies Act 2013** include:



*Companies (Management and Administration) Rules 2014



The listed entities that have listed its specified securities on any recognised stock exchange(s) either on the main board or on small and medium enterprises (SME) exchange or on institutional trading platform are required to make the following additional intimations and disclosures to the stock exchanges, as applicable to them basis their listing status, under the **SEBI Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015**.



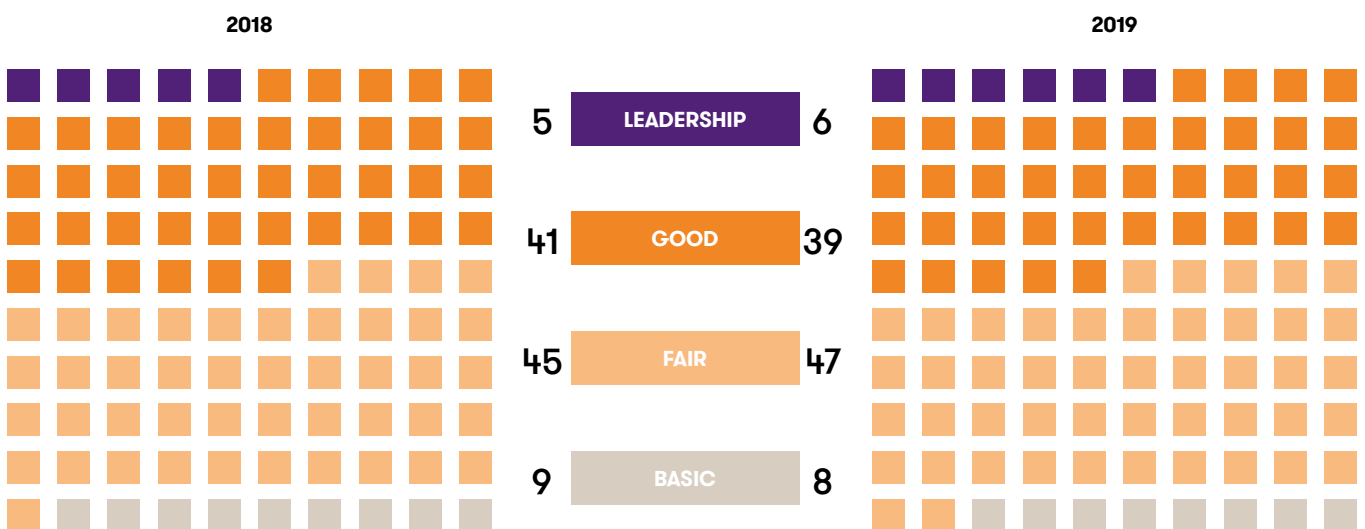
*SEBI LODR Regulations

Note: For disclosures on the website, listed companies are required to maintain a functional website containing the basic information of the company and mandatory disclosures under a separate section. (The disclosure of material events or information are required to be hosted on the website for at least five years)



Regulation 4 of the SEBI LODR Regulations, 2015 provides broad principles for periodic disclosures and corporate governance by listed entities. The principles for periodic disclosures are based on the principles given by International Organization of Securities Commissions (IOSCO) and the principles for corporate governance (in line with Organisation for Economic Co-operation and Development principles).

Indian corporate governance scorecard



Note- The figure exhibits the distribution of corporate governance scores 2019 for the BSE 100 companies. The scorecard provides a fair assessment of corporate governance practices at the corporate level and helps investors to assess the corporate governance levels of their portfolios

Board's response to COVID-19 risks

COVID-19 is forcing boards across the globe to confront a host of difficult questions on how business should be conducted during a global health crisis. The board oversight to ensure accuracy of required disclosures becomes critical

Listed entities would need to ensure that if there is a material effect on the business or operations of the company, whether arising directly or indirectly on account of the COVID-19 pandemic (e.g. closure of an important manufacturing facility due to supply chain disruptions), the required intimation needs to be sent to the stock exchanges where the company's shares are listed. Disclosures and communication about the current and potential impact of the COVID-19 on the business and operation should be carefully planned and coordinated with the legal teams to ensure compliance.

Given that board and committee meetings are being virtually held, governance practices, such as advance notice of meetings, sharing of agenda and board papers as well as faithful depiction of the proceedings, including objections from specific directors in the minutes gain utmost importance.

Moreover, conscious of the limitations of social distancing where the boards rely on unconventional means of engagements, the compliances have been relaxed by the MCA and SEBI with certain corporate governance provisions of the Companies Act 2013 and the SEBI Act as well as the regulations under the SEBI Act, as a result of COVID-19.

However, it is pertinent to note that these relaxations have dispensed with formal and administrative requirements but not relieved corporate boards of their obligations as fiduciaries. Directors continue to bear the burden of various duties imposed on them under corporate law.

SEBI has advised India Inc. to make enhanced disclosures on COVID-19 business impact

Such disclosures should be in good faith with appropriate disclaimer on the financial impact of the crisis



Our view

In the present times, transparency, disclosure, accountability, issues of sustainability, corporate citizenship, globalisation are some of the concerns that the boards deal with. It is vital for boards to communicate with shareholders regarding company's assessment and its action plan to tackle the potential impact of COVID-19 pandemic.

- Re-assessment of revenue and profitability projections may be required. It is crucial to maintain confidence of shareholders, particularly, for companies that have suffered disproportionate impact of this pandemic.
- In the interest of protecting minority shareholders, the principle of 'equality of disclosure' should be practised, such that all shareholders receive information equally.
- Enterprises should disclose significant transactions with related parties. The beneficiary ownership structure, changes in the shareholdings of substantial investors should be disclosed to all interested parties as soon as a company becomes aware of them.
- Proactive mode of communication with the sectoral regulators and governmental agencies by the boards would enable them to procure timely guidance from the authorities and would help them navigate better.

Board's oversight to ensure the accuracy and timeliness of disclosures is more critical in these circumstances. Besides, with clear and improved disclosures, reporting regimes have been strengthened overtime where the statutes are continuously evolving according to the needs of stakeholders.



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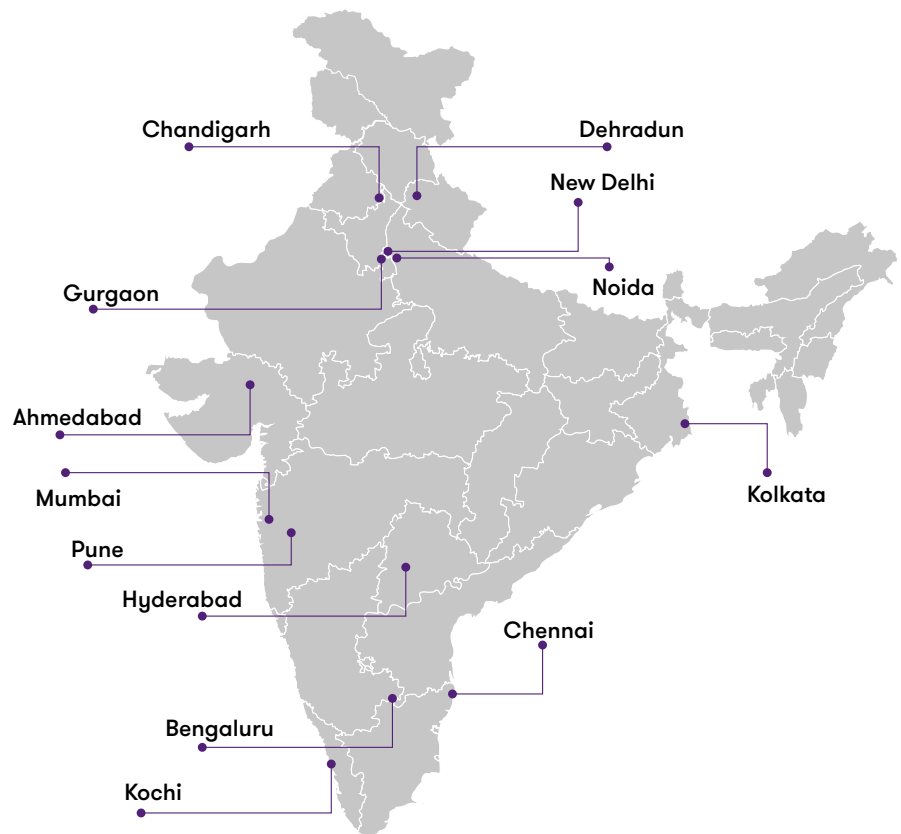
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Acknowledgements

For more queries, contact

Dinesh Anand
National Managing Partner, Risk
E: dinesh.anand@in.gt.com

Saket Mehra
Partner, Risk
E: saket.mehra@in.gt.com

For media queries, please contact

Rohit Nautiyal
E: rohit.nautiyal@in.gt.com

Author

Priyanka Mehra

Editorial review

Sneha Bhattacharjee

Design

Gurpreet Singh

Contact us

To know more, please visit www.grantthornton.in or contact any of our offices as mentioned below:

NEW DELHI

National Office,
Outer Circle, L 41,
Connaught Circus,
New Delhi - 110001
T +91 11 4278 7070

NEW DELHI

6th Floor,
Worldmark 2,
Aerocity,
New Delhi - 110037
T +91 11 4952 7400

AHMEDABAD

7th Floor,
Heritage Chambers,
Nr Azad Society,
Nehru Nagar,
Ahmedabad - 380015

BENGALURU

5th Floor, 65/2, Block A,
Bagmane Tridib, Bagmane
Tech Park, CV Raman Nagar,
Bengaluru - 560093
T +91 80 4243 0700

CHANDIGARH

B-406A, 4th Floor,
L&T Elante Office Building,
Industrial Area Phase I,
Chandigarh - 160002
T +91 172 4338 000

CHENNAI

7th Floor, Prestige Polygon,
471, Anna Salai, Teynampet,
Chennai - 600018
T +91 44 4294 0000

DEHRADUN

Suite No 2211, 2nd Floor,
Building 2000, Michigan Avenue,
Doon Express Business Park,
Subhash Nagar,
Dehradun - 248002T
T +91 135 2646 500

GURGAON

21st Floor, DLF Square,
Jacaranda Marg,
DLF Phase II,
Gurgaon - 122002
T +91 124 462 8000

HYDERABAD

7th Floor, Block III,
White House,
Kundan Bagh, Begumpet,
Hyderabad - 500016
T +91 40 6630 8200

KOCHI

6th Floor, Modayil Centre Point,
Warriam Road Junction,
MG Road
Kochi - 682016
T +91 484 406 4541

KOLKATA

10C Hungerford Street,
5th Floor,
Kolkata - 700017
T +91 33 4050 8000

MUMBAI

11th Floor, Tower II,
One International Center,
SB Marg Prabhadevi (W),
Mumbai - 400013
T +91 22 6626 2600

MUMBAI

Kaledonia, 1st Floor,
C Wing, (Opposite J&J Office),
Sahar Road, Andheri East,
Mumbai - 400 069

NOIDA

Plot No 19A, 2nd Floor,
Sector - 16A,
Noida - 201301
T +91 120 485 5900

PUNE

3rd Floor, Unit No 309-312,
West Wing, Nyati Unitree,
Nagar Road, Yerwada
Pune - 411006
T +91 20 6744 8800

For more information or for any queries, write to us at contact@in.gt.com



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