Decoding regulatory reporting

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Key takeaways:

- *There is a push from both regulators and investors, to further enhance the quality and relevance of corporate reporting.*
- *Non-financial metrics including those on ESG are becoming more prominent on capital allocation decisions, and hence there is a need for corporates to evolve towards an integrated corporate reporting approach, accompanied by integrated assurance.*

Corporate reporting in India continues to evolve, with both investors and regulators playing a role in shaping the reporting landscape in the country. While certain changes are driven by investor priorities, many others stem from the regulators' experience and concerns on the quality and level of transparency in corporate reporting. In short, corporate reporting has been keeping pace with relevant business and market trends.

There are three broad areas of change that corporates need to focus on over the next few months.

- First, the enhanced financial disclosure requirements for corporate financial reports, with the requirement of the revised Schedule III of the Companies Act, 2013 becoming applicable for this year-end
- Second, changes focussed on protecting the interests of minority shareholders and investors in the capital markets, including enhanced disclosures by corporates with debt and equity listed securities, and the new requirements on related party transactions
- Last, the shift of focus from pure financial disclosures focussed on shareholders to a broader set of disclosures and metrics, including Environmental, Social, and Corporate Governance (ESG), focussed on the interests of all stakeholders, including the adoption of Business Responsibility and Sustainability Reporting (BRSR) norms introduced by SEBI.

Corporate financial reports

The adoption of the Revised Schedule III brings in several new disclosure requirements, aimed at improving clarity, quality, consistency, transparency and highlighting high risk indicators with the intent of providing relevant information to protect the interests of users of these financial statements. The enhanced disclosures around corporate social responsibility (CSR) expenditure, accounts payable, fixed assets are meant to enhance clarity, whereas those relating to ageing and related analysis of certain categories of assets, revaluation of intangible and fixed assets and fair valuation of investment property are meant to enhance the quality of the information reported. Similarly, the disclosures on ratios and classification of borrowings drive consistency, whereas those relating to assets and their title deeds, loans and advances to related parties, Key Managerial Personnel (KMP), promoters, etc., changes in promoter shareholding, borrowings against current assets, disclosure on use of proceeds from borrowings are aimed at enhancing transparency. Further, it also looks at complex structured transactions and requires companies to disclose any loans, advances, investments to intermediaries for the benefit of an ultimate beneficiary, either through loans, investments, guarantees, etc. It also requires disclosure of higher risk indicators, such as the existence of benami properties, transactions with struck-off companies, wilful default, and declaration of previously undisclosed income.

Many of these require significant effort by companies, including demonstration of steps taken to ensure accurate reporting, and also for auditors to express an opinion on this information. All of these require companies to realign their internal financial controls and financial statement closure process.

Focus on investor protection for listed companies

SEBI has recently revamped the requirements on related party transactions for listed companies. It has expanded the universe of related parties and enhanced the coverage of covered transactions to those of the entire group (rather than just the listed company). It also has introduced new approval requirements at the Audit Committee and shareholder levels and amended the requisite disclosures to shareholders apart from making many other significant changes in the process and related documentation. In addition, only independent directors on the Audit Committee are now allowed to approve related party transactions.

This requires a significant step up for companies with large and complex groups and significant related party transactions, to put in place systems, processes and technology to be able to gather and report this information, internally, to the Audit Committee and to the regulators and shareholders.

Extended external reporting

Lastly, there has been an enhanced focus on reporting beyond just the traditional financial metrics. This has become even more important in recent months, in particular post United Nations Climate Change Conference (COP26), when investors and regulators across the world are stepping up their expectations on climate change and protection of broader stakeholder interests. In turn, companies are making commitments on carbon neutrality, net-zero commitments, and other sustainability initiatives, together with a focus on enhancing their ESG credentials through a variety of actions and enhanced communication. It is in this context that the BRSR reporting mandated by SEBI for the top 1000 listed companies becomes relevant. While it is mandatory from FY23, several companies are seeking to voluntarily early adopt BRSR for FY22 as well along with the sustainability or integrated reports, in compliance with one or more global standards or frameworks.

Thus, extended external reporting, combining financial and non-financial metrics, including ESG is becoming the norm. Here the interplay between these financial and non-financial elements becomes relevant as well, as the financial reporting standards (such as Ind AS) do not operate in a vacuum. When companies make ESG oriented statements and commitments, they also have financial reporting implications. For instance, there is now a growing focus from investors and regulators on climate risks in financial reporting.

It is also important to note that there are multiple standards and frameworks currently in use by corporates and this is accompanied by more recent local regulatory directives, including the EU Taxonomy, and the proposed rulemaking by the U.S. Securities and Exchange Commission. Hence, there is a growing support from investors and companies alike for a global set of baseline standards leading to the IFRS Foundation announcement of the formation of the new International Sustainability Standards Board (ISSB), a body that will develop a comprehensive global baseline of high-quality sustainability disclosure standards focussed on enterprise value. The convergence and the global adoption of these standards is expected to see much quicker evolution as compared to what one saw on the convergence on financial reporting.

In summary, corporates and audit committees will need to deal with a lot as they enter 2022 from an external reporting standpoint. Integrated corporate reporting – combining financial and non-financial metrics, including ESG is the clear way forward, together with integrated assurance on such reports.

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