

National Foundation for Corporate Governance

National Conclave on Corporate Governance in India : *Disclosure Practices – Accounting and Audit*

10 October 2007 : Bangalore

Inaugural Session

Keynote address: **Mr. Jitesh Khosla**
Joint Secretary,
Ministry of Corporate Affairs,
Government of India

It is a great pleasure to be here and to be sharing one's ideas on how things have developed and the likely directions in which they are going to go with an audience such as this and it is a rare and a good opportunity which I believe every bureaucrat must not let go. So when I was informed about this I immediately said yes. Apart from the fact that it would be a good opportunity to meet Mr. Maira again. It would also be an opportunity to share one's ideas and thoughts on some of the issues that has have lot of contemporary relevance.

Friends, We all, not only we but the entire world has remarked the manner in which the Indian economic and the corporate scenario is changing. There is definitely a huge amount of transformation, which is taking place. It is reflected in so many things. It is reflected in the growth figures. It is reflected in the manner in which Indian corporate sector is expanding overseas. As a matter of fact from the information and data available we are quite inteedged by the number of companies which Indian corporates have acquired overseas runs into hundreds. The Global presence of Indian corporates the increasing respect and regard for the competence and the professional expertise of the Indian professionals, Indian CEOs, Indian professionals, experts they are

spreading global wings. So these are all manifestations of a transformation but what kind of transformation is taking place. Lot of things are changing, sizes are changing, lot of people are going to public for raising money. Our Capital Market is swinging up and hopefully not down. But capital markets do have a tendency to go up and down but very robust, moving very well and good opportunities but it is changing in some more ways than what are immediately obvious. One of the transformations, I don't know may be CII could study that part also may be they already have, may be not in this forum but some other forum. The nature of the business is changing. Those who are the top 30 may be 20 years ago are no longer, they no longer fill the list. New companies have moved in. And even the new companies may find their stay short lived. Even newer players will enter and replace them in the top 30. What is exactly happening? Amongst lot of other changes one change which is taking place is that the nature of business has changed. At one time when business was serving the elite few at the one end and engaging in expropriation on the other it had a different paradigm in which it was working. Lot of business was done on land and Commodity, trade and Commodity based activity. So there the nature of the business was expropriation of certain margin of profits, certain percentage of the profit. India did not have markets in a number of areas, in a number of sectors but it did have the privileged few. So at the other end of the spectrum businesses were catering to the requirement of these small groups.

If you are a bank you had a few privileged customers and you took lot of time, care and effort to look after them. If you are selling a car then may be the town where you lived or worked had about 15 or 20 persons you personally walked over to them and made sure that they got the good car. I am talking about the era gone by. That has changed. Business has entered in a lot many more sectors, lot of these areas where business and corporate entities were not operating they are operating today but more than that there is the emergence of the market, the mass Market, the huge market which is waiting and ready to consume. Now in this market the new business opportunity, which has been spotted by lot of enterprising people, is not only the capacity but also the desire to identify and fill the need for a service, for a product or for anything. You are looking at a huge market And as a part of your entrepreneurship you are looking at a certain need which the market has or certain segments of the

market has and you move into fill that need or to provide the service. So no longer pandering the privileged few. There are of course a few elite club here and there so that's okay in the clubs will be there that his okay and they should be allowed to. But I think the future will be the energy, the innovation and enterprise a business brings to be able to fill and provide satisfaction to a large number of people, a huge market so that whenever that a person or an entity in that market thinks of this business it thinks of oh, these guys are doing a good business – from privileged to service and that is where there is a huge opportunity for growth or a huge opportunity for expanding into new businesses.

Now if these are the changes which are taking place there have to be corresponding changes in other aspects also. Mr Maira and Mr Shenoy referred to the many ways in which the regulatory landscape is changing. Yes, it has been changing and there has been a huge legislative program which during the last few years has been engaged in transforming the legal or the regulatory landscape in India. Lot of these changes have taken place. To go into all of those of course, would be time consuming but I think it would be useful for the corporate sector or for other participants to fully understand and contemplate those changes. But at the same time one new need has arisen for the regulator as well for the lawmaker as well. With these changes the situation has become extremely dynamic. Everything is changing, new needs are coming up every day, new markets are emerging every day, new ways of dealing with the market are emerging every day, new business models are coming up every and each one is more successful than the last one. So if that is the dynamism then definitely the regulator, the lawmaker or the government whatever you call has to keep base because otherwise the consequences are not difficult to imagine. It would impose unnecessary constraints on the spirit of entrepreneurship or the innovation which the Nation as a whole would have. Now to provide that kind of an input the regulators also need to interact. I must say that NFCG and the efforts taken up by CII do provide this kind of an opportunity. It is an opportunity not only for us to share our ideas and thoughts but it is also an opportunity to imbibe, to understand what are the changes that are taking place, how people are reacting to new situations. All in all it raises the level of debate so that at the time of regulation or at the time of rule making or law making these are some of the impressions which

are kept in view. So therefore, events such as these, the activities of the National Foundation for Corporate Governance or events of CII or FICCI. I think apart from being representational role, I think it is time they have evolved into some kind of a interactive mode, very useful if you are looking at changes in the regulatory structure to keep pace with the dynamism in the economy. But then if that is the kind of background what are the imperatives for a corporate entity when it moves into such a dynamic market, such as changing market? Well if you are moving in to an area where your capacity to provide a product or provide a service is going to be looked at a huge- huge market, at a huge uncontrollable market then it is very important for you to come out and disclose and reflect very clearly as to who you are and what you stand for. A consumer or a customer or a market participant takes his view based on a number of factors and one of those is definitely an intangible factor really but which reflects in the mind of the consumer as to whether the overall approach and philosophy of this company does it inspires credibility and confidence or not? Now these are important issues and this is not something, which you can put down in the rule or regulation or law. This would lie in the domain of Corporate Governance. So Corporate Governance something of a buzzword, maybe ten or fifteen years ago is very clearly a necessity today.

For a company to take a position in the market, for a corporate entity to position itself in a particular segment or a particular position in the market very categorically and very clearly it has to come out with its own thinking. It has to have confidence in its own thinking so that it can tell that to the world. And finally it must tell to the world it must come out clearly as the company (a) which believes in doing something and is capable of doing something and (b) whose words and actions are in synch, they reinforce each other. So therefore, Corporate Governance in the days to come, in the competitive situation in the Indian Market would provide a certain value and a certain lever to a company to present itself to the consumer and that is very important. Maybe a consumer or a customer would take his position based on that. Maybe not on the product itself but maybe based on that who you are? definitely not all these aspects can be put in the law. So law and regulation can go only up to a point. Here we are talking about areas which will really go beyond the realm of law, regulation or the written rule of the law. We have to

go into what you can call not only the spirit of the law but the spirit of who you are, the spirit of what you believe in -that is going to be critical.

Friends with this background let me delve for a while of the subject matter of this particular conference, this particular interaction. This is intended to focus on an area which on the face of it appears to be dull and dry. Disclosure Practices – Accounting and Audit, the minute you hear Disclosure Practices – Accounting and Audit you will call a chartered accountant and say let him deal with it. But if we reflect a bit on the manner in which things are changing I think a new meaning has to be attributed to this kind of activity. So therefore, if we are going to look at issues relating to your own philosophy, your own thinking, your own positioning, if you are looking to imbue a sense of credibility and reliability to what you are saying then you have to go beyond the letter definitely, beyond the spirit of the law and definitely give a reflection of your own thinking into certain aspects through a process which led us, for want of better words call the process of disclosure. One of the debates which keeps on taking place off and on that in India the corporate sector is over regulated. I have a feeling and more I listen to that debate more that feeling grows that there is a lot of confusion between regulation and control. I think in many cases these two concepts get used interchangeably. Control is a different aspect that relates to centralized decision making on certain allocative and certain business decisions. But regulation is not control; regulation is aimed at facilitation aimed at ensuring fairness, level playing field, competition and equity. So regulation is something which is necessary for an economy to grow, for corporate entities to grow for business entities to grow, for entrepreneurship to develop the answer perhaps is not absence of regulation. The answer is perhaps the quality of regulation, the efficiency of regulation and the relevance of regulation. So therefore, you are looking at a new paradigm for governance through regulations which itself is in a dynamic mode as dynamic as the economy that is seeking to regulate. Even within his regulatory structures there is a strong argument made that there are certain areas where there is considerable scope for self regulation. This sounds very simple but it comes with a huge baggage of legacy.

An approach towards self regulation depends on the perception that you have about the business, industry or economic activity as such. If you look at it

through the degree of distrust then it will take a different turn. But if it is looked at with an approach of trust then some of the responsibilities which the regulator and state assumes upon itself can be and may be, should be transferred on to the entity which is itself being regulated. So if you are operating as a corporate entity and if you are asked to take up self regulation what exactly would that entail? First and foremost disclosures. Before anything else takes place, before the other chain of events, before the regulatory work, action or anything takes place First and foremost it has to be disclosures. A regulatory structure which incorporates self regulation as a part of its strategy will essentially and necessarily impute a certain importance to disclosures and equally stringent penalties for non-disclosures. Because providing for disclosures has no meaning if non-disclosing that thing carries no consequences. Of the disclosures I think the most important disclosures apart from your own corporate philosophy and your own corporate approach it is going to be the disclosure of your financial information. So therefore, when you look at the disclosure practices, when you are looking at the accounting and audit as a component of disclosure activity then you have to take a view which goes a little the beyond the mere rules and guidelines of accountancy and audit. You have to take a view on what exactly is the message that you are going to give to your shareholders. What is the message you are giving to your potential investors? That has to form a component of your disclosure policy. In addition to that you have to make sure that whatever you are saying is reliable, credible information. All these components have to come together. Accounting and audit are inputs. They support this process; they enable this process but in the final analysis the policy on disclosures even with the accounting and audit will depend upon the corporate governance practices of the entity as also on the regulatory system which will compel a certain amount of disclosures to be met.

So friends, there you are and let's take the papers back from the chartered accountants for a minute and let us then think of what exactly will be involved in accounting and the use of accounting audit for your disclosure practices. Well for one thing, it is very useful to take a note of some of the trends which have taken place. We have been working on a study of international accounting standards as reflected in the International Financial Reporting standards there is a National level body, National Advisory Committee on

Accounting Standards, ICI is part of that and we have been working on what you can call harmonization, process of harmonization between the Indian accounting standards and the international accounting standards. This exercise took five or six years and in December, 2006 Indian accounting standards have been notified by the government. Before this the accounting standards have been brought out from time to time by ICI and they have been given the status of deemed accounting standards but now they have been notified by the government, meaning compliance is a part of your regulatory compliance. Therefore, to be sure that you are in compliance with the regulatory system you have to make sure that you are in compliance with the accounting standards, 28 accounting standards have been issued and we are working on some more and some more are likely to come.

There is also talk about working on industry specific standard but this is something more at the thinking stage but 28 accounting standards have come out. These are at par, maybe a few differences here and there with the International Accounting Standards. The implication is that for the Indian entities the accounting practices the principles that they would be using that would be acceptable and they would be valid and credible in an International arena. Now for an Indian entity to comply with accounting requirements of capital markets elsewhere the last step is a very small one. May be in a few areas and over a period of time those areas will also be looked at. So you have the accounting standards which are a part of the legal requirements. Next, you have a wonderful, excellent disclosure platform and it is not the ROC's office, it is your own computer screen. The MCA 21 program converted the registry into a fully operational electronic registry which brings the ROC's office to your office. Not only for the purposes of statutory filing and so on so forth but also for access to information, for looking at company information, documents and so on for other companies are available on your screen, 24x7, 365 days anywhere, any place. Indeed this has been a major major shift. What does it mean? It means that whatever a company does whatever a company discloses is instantly and instantaneously available over a huge platform and can be accessed and can be looked at but any number of stakeholders anywhere and believe me that we have been receiving over one million hits a day on our system. So you are living in a glass house. Accounting standards

and the platform for disclosures - these are the two areas which are moving in parallel.

We are looking at certain other areas of reforms as you would know that in terms of the areas of measuring income you cannot have different ways of recognize an income. There has to be common. Disclosures, there can be some variations but not between one company and another but between classes of companies. There may be a certain lesser disclosure requirement say, for a small company. There would be no change in the certain recognition of the income measurement requirement, they would remain the same. There would be a common regulatory system for all of them but the regulatory system could differentiate in the disclosure requirements. Therefore, if you are a widely held public company disclosure requirement can be more stringent. If you are a small company maybe they could be less stringent. For that we have taken up the review of the schedule VI of the Companies Act which is a very important instrument for disclosure. We expect to complete this review and may be in the time to come this would be the third element - the accounting standards that gives you the concept and principles which are to be followed, platform for disclosures, the requirement for disclosures in the form of Schedule VI and so on and so forth.

When you look at the future, what is the future going to be? Well work has already started on improving the efficacy of presentation of financial information. Computer languages like XBRL and so on and so forth are being developed. The ICI has already taken up an exercise as to how XBRL based disclosures could be made in the future. Not only are you disclosing your information that information can be collated and that can be seen and extrapolated in a particular way, which of course gives lot of strength and power not only to the investor but also to the regulator, the big brother who has been watching carefully what exactly you have been up to. Either way the quality of disclosures will definitely improve over a period of time and quality of access, analysis and understanding of disclosures will also go up. This is one area that we are working on. We are also working on certain additional legal requirements such as addition of the cash flow statement to the balance sheet and Profit and Loss statement but in the final analysis disclosure will not only depend upon the regulatory system, to be true, disclosures will have to

be made because the law will require the disclosures to be made. If you don't make those disclosures they don't reflect your balance sheet but the quality of what you disclose and I go back to the original point when you are telling the market you are and what you are what you want to do will eventually depend upon the Corporate Governance within that entity. It will depend upon the quality and manner of thinking of the CFOs who are heading the Financial Operations of the company. A lot will depend on that. A lot will depend upon the audit committees of the company, the kind of requirements they compel the company to undertake. A lot will depend upon the internal processes, the internal financial controls of a company.

It will eventually be a combination of the regulatory requirement on the one hand and the seriousness with which the company has taken the Corporate Governance mandate in the financial side, in the context of the quality of its CFOs, the quality of its financial controls and so on so forth, the empowerment it gives to the audit committees, a lot of things are going to be dependent upon them. MCA 21 will carry the message to millions and millions of viewers. One million hits a day and the number is rising, just remember that. So remember what you do is one thing but what you think even what you think as to who you are is something which is going to be instantly available to your customers, consumers and nothing is going to remain hidden. Therefore, while we will continue to work for the high standards for the auditors to follow, we will continue to work for ensuring independence of auditors, we will continue to reform the regulatory structure and finally the meaning the essential spirit that will have to be imbued to disclosures is what the corporate sector itself though its own corporate governance philosophy imparts. That is going to be important.

Thank you
