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A V Vedpuriswar & S Subramanian: What disclosure?

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The quality of disclosures, even from some of the country's top corporations, leave much to be desired.

Most listed companies claim they adhere to high standards of corporate governance. However, a sample of the information provided by companies in their annual reports under the head "Management Discussion and Analysis" (MD&A) suggests few actually do, and this applies to highly respected companies as well.

Annual reports provide investors with financial statements and data. But even sophisticated readers of annual reports have difficulty in understanding the language of financial statements and the underlying rules and conventions.

The MD&A section seeks to fulfill this objective by providing both short- and long-term analysis of a company's business prospects.

Indeed, following the Kumaramangalam Committee Report in 1999, the Securities and Exchange Board of India made it mandatory for companies to give certain details in the MD&A report as part of the annual report from 2000, including information like industry structure and developments, opportunities and threats, risks and concerns, and material developments on the human resources front, among others.

The MD&A report of Dr Reddy's for the year 2003 states: "Currently, only process patents are recognised in India. However, by virtue of India being a member of the World Trade Organisation, India has recently passed a legislation to recognise product patents from 2005. This does not affect a discovery-based company like Dr Reddy's. However, it will affect companies that survive only on reverse engineering".

But with generics contributing Rs 189.6 crore out of a total profit before tax of Rs 431.3 crore during 2003, the company's claim that it is "discovery-based" is quite misleading.

The company's 2003-04 report has mentioned that India is moving towards a product patent regime. This development has major repercussions for the Indian pharma industry.

The MD&A report is somewhat misleading as it seeks to create an impression that the product patent regime is tailor made for the company.

In the case of Infosys, despite the fact that former employee Reka Maximowitch filed a sexual harassment suit involving senior executive Phaneesh Murthy in December 2001, the 2001-02 annual report did not mention this, and investors came to know about the incident only when Murthy resigned from the company in July 2002.

The 2002-03 annual report covered this issue, but in very general terms: "An unfavourable resolution could adversely impact Infosys' results of operations, or financial condition."

The company could have made an attempt to quantify the possible damages. Besides, the report did not mention the company's plans to settle the issue outside court. Finally, Infosys paid $3 million to the plaintiff in an out-of-court settlement.

Infosys' risk-management disclosures are long on gloss and short on substance. Take, for instance, foreign exchange risk. The 2003-04 annual report merely mentions that any change in the dollar-rupee value will affect the company's performance but even a basic sensitivity analysis has not been provided.

The 2004-05 annual report says: "Our functional currency is the Indian rupee, although a major portion of business is transacted in foreign currencies. Last fiscal, we derived our revenues from 50 countries, of which 79.4 per cent were US dollar denominated and majority of our expenses were in Indian rupee. The exchange rate between the rupee and dollar has been changing substantially, and we face the risks associated with exchange rate fluctuations and translation. The appreciation of the rupee against foreign currencies adversely impacts our profitability and operating results…. Our risk management policy ensures that expenses in local currency are met through receipts in the same currency. We seek to reduce the effect of exchange rate fluctuations on operating results by purchasing foreign exchange forward contracts to cover a portion of outstanding accounts receivable. Contracts in non-US and non-EU regions are in internationally tradable currencies so that we are not exposed to local currencies that may have non-tradability risks."

ICICI Bank, considered one of India's best performing banks, mentions in its 2003-04 report that the Basel II norms will have a big impact on the way banks manage their operations.

But the report does not provide any detailed discussion on this, especially with respect to important areas such as market risk management and credit risk management.

We also notice that some companies tend to misrepresent information using convoluted logic. For instance, the 2002-03 annual reports of many fast-moving consumer goods (FMCG) companies gave two reasons for the poor performance of the FMCG sector.

One was the weak economy. The second was that consumers were diverting their expenses towards consumer durables. These are contradictory statements. Consumers are hardly likely to purchase consumer durables if the times are bad!

Moreover, it is a far fetched argument that consumer durables are acting as a substitute for consumer non-durables, especially when the per capita consumption of basic consumer goods is quite low in the country.

What is needed is a genuine attempt by companies to tell investors all that they need to know, and not just what the law stipulates. Even our best managed companies have a long way to go in this regard.

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