Disclosure of information related to forensic audit of listed entities

1.0 Objective

1.1. This memorandum seeks the approval of the Board to mandate disclosure of information related to forensic audits of listed entities by amending the SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015 **(‘LODR Regulations / LODR’)**.

2.0 Extant regulatory provisions

2.1. As per Regulation 30 (1) of LODR, every listed entity shall make disclosures of any event or information which, in the opinion of the board of directors of the listed company, is material. Further, certain events specified in Para A of Part A of Schedule III of LODR are deemed to be material events and listed entities are required to make disclosure of such events, as soon as reasonably possible and not later than twenty-four hours from the occurrence of event or information.

3.0 Importance and need for disclosure of information regarding forensic audits

3.1. Forensic audits of listed entities are generally initiated by lenders, management of a listed entity or regulatory / enforcement agencies. Lenders or the management of a listed entity generally initiate forensic audits when something appears to be amiss with the entity’s financial statements pointing to misstatement, misappropriation and perhaps, siphoning of funds; it is thus designed to uncover a fraud / mis-utilization, which underlines the seriousness of such audit. On the other hand, in cases where regulatory / enforcement agencies initiate audits, the objective of the audit may be specific to the mandate of the agency and may be part of a broader investigation. If the investigation of the regulatory / enforcement agency results in any material regulatory action against the listed entity, the action along with its impact, is required to be disclosed as per the existing disclosure requirements specified in the LODR.

3.2. In the recent past, there have been cases where forensic audit of listed entities has been initiated by lenders or the management but the fact of initiation of the forensic audit and the complete report of the forensic audit, has mostly not been disclosed by listed entities to stock exchanges.

3.3. In such cases, the information on possible financial distress of the listed entity is available only with certain parties such as the promoters or key managerial personnel (KMPs) of the listed entity, third parties such as lenders; whereas other concerned regulators and minority shareholders are not informed of the potentially negative information. Non-disclosure of such information creates information asymmetry in the market and results in unequal access to disclosures. Further, in few cases, there have been instances of leakages of forensic audit reports in the media, thereby exacerbating concerns on information availability with only few persons / entities.

3.4. Considering that the findings of these audits may have a significant bearing on decision making by investors, it is important that complete disclosures are made by listed entities in this regard. Further, in order to get a perspective of the management of the listed entity, such disclosures may be accompanied by the comments of the management, if any.

4.0 <u>**Proposed amendments to LODR**</u>

4.1. Considering the above, in order to address the critical gap in the availability of information to investors, it is proposed that in case of initiation of forensic audit (other than those initiated by regulatory / enforcement agencies), listed entities may be mandated to make the following disclosures to stock exchanges, without any application of materiality:

4.1.1. The fact of initiation of forensic audit (by whatever name called) along-with name of entity initiating the forensic audit and reasons for the same, if available;

4.1.2. Final forensic audit report, on receipt by the listed entity, along with comments of the management, if any.

Para A of Part A of Schedule III of LODR, which specifies the list of events that are deemed to be material, may be accordingly amended as detailed at Annex 1.

5.0 **Proposal to the Board**

The Board is requested to consider and approve the amendments to SEBI LODR Regulations as mentioned at point 4 above. The Board is also requested to authorize the Chairman to take consequential and incidental steps, as may be required, to give effect to the decision.

Annex 1

Schedule III

PART A: DISCLOSURES OF EVENTS OR INFORMATION: SPECIFIED SECURITIES [See Regulation 30]

The following shall be events/information, upon occurrence of which listed entity shall make disclosure to stock exchange(s):

A. Events which shall be disclosed without any application of the guidelines for materiality as specified in sub-regulation (4) of regulation (30):

1….
2….
….
….
….
16.
17. Initiation of Forensic audit (other than those initiated by regulatory / enforcement agencies): In case of initiation of forensic audit, (by whatever name called), the following disclosures shall be made to the stock exchanges by listed entities:

a) The fact of initiation of forensic audit along-with name of entity initiating the audit and reasons for the same, if available;
b) Final forensic audit report on receipt by the listed entity along with comments of the management, if any.