CHAPTER 1

INTRODUCTION

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INTRODUCTION

1.1 BACKGROUND

Sri Lanka has a mixed economic system, which involves government and private sector participation in the process of production and distribution of goods and services. In a mixed economic system, the government economic units, private institutions, and individuals contribute towards capital formation. Private sector of an economy, mainly, consists of sole-proprietorships, partnerships, and companies registered under the Companies Act. Registered companies obtain their equity capital by issuing shares and debentures. In Sri Lanka, private companies and unlisted public companies are, generally, family concerns. Public listed companies issue shares to public to obtain equity capital. The issue of debentures to obtain loan capital seems to be not popular in Sri Lanka.¹

The primary and secondary markets provide the mechanism for capital formation of public listed companies. Security holders are the providers of equity capital and loan (debenture) capital to the listed companies. The main objective of a holder of shares is the long-term maximization of his wealth relevant to his holdings. The wealth of a shareholder at a point of time could be defined in monetary terms as the current market value of securities. In order to maximize his wealth, a shareholder would have to make judgments and decisions relating to ‘Buying’, ‘Selling’, and ‘Holding’ of securities. While rational judgments and decisions would contribute towards maximization of wealth, the irrational ones would lead to loss of wealth. Rational decisions could be made on the basis of

¹ According to the information given in the Stock Market Daily of 8 September 1999 (Page 13) only 9 companies had quoted debentures, and only 3 companies of them had ‘ask’ and ‘bid’ prices.
factual information and futuristic estimates derived from the factual information. The factual information could be historical or current. Futuristic estimates provided on the basis of historical and current information are very significant for the decision making of shareholders. A considerable amount of historical and current information and futuristic estimates disclosed and reported by the listed companies are accounting and accounting related. The accounting and reporting systems prevailing in Sri Lanka have been inherited from the British. “...countries in the then Indian sub-continent [Sri Lanka, India, Pakistan, and Bangladesh] retained the accounting system that was imposed by the British.”² The theory, tradition, and practice of the United Kingdom influence annual reports produced by the listed companies in Sri Lanka.

Information for decision making, involving risk and return may be available with the share-brokers, professional investors, investment analysts, business journalists, trading floor and etc. However, the ultimate source of information is the relevant listed company to which the information is associated. The annual report is the main document providing listed company information to external parties.

It contains accounting as well as non-accounting information. Publication of the annual report of a listed company is a statutory and regulatory requirement of the Companies Act and the Colombo Stock Exchange, respectively. Generally, an annual report of a public listed company provides more information than any other document supplied by the directors to its shareholders and other actors of the share market. Historical results, information of current position, and future expectations are the three major types of information usually reported in an

annual report. Mandatory as well as voluntary disclosure of accounting information is included in them. The voluntary inclusion of future expectations in the annual report is a new trend introduced by the companies. Some writers on disclosure in annual reports have highlighted the danger of overemphasizing voluntary disclosure in annual reports. As Lee\(^3\) says “financial reporting for stewardship and decision purposes appears to have been overtaken by the voluntary part of the annual report. If financial data take a secondary position in the annual report of large and complex corporate organizations, this creates concerns about the quality of accountability and governance.”

If financial information disclosed in the annual report is comprehensive and graspable to the shareholders, the annual report could be the major source of information for decision making in the stock market.

According to the findings of accounting researchers, current reporting practice in annual reports has encountered problems. Studies have revealed that the disclosure in published corporate annual reports is not satisfactory.\(^4\) As Putnam\(^5\) states “the most frequent criticism is that annual reports do not give enough information to determine the investment quality of the enterprise... The issues involving accountability, reporting, and disclosure have been problem areas of the financing communities for a long period.”

The issue of corporate accountability is undoubtedly topical, but the problems encompassed by the term are not new. Indeed, they are as


\(^5\) Putnam, Donald F.; *Disclosure Criteria for Business Enterprises*; Unpublished Ph.D. dissertation submitted to the Faculty of Claremont Graduate School in the Graduate Faculty of Business Economics, USA, p. 17.
old as the separation of ownership and control with its history of problems in trading off the interests of various stakeholders. It is no coincidence that the role of, and justification for, financial reporting not only shares some of the same history, but stems from many of the same issues and problems.6

The rapid development of communication process and application of computer technology to business organizations have not only improved the reporting through annual reports, but also have challenged the significance of annual reports as a media of communication.7

According to Beaver8, in the recent past, the main emphasis of accounting theory has been on the needs of users of accounting information, and more specifically, those data which will aid in prediction and related economic decisions. What to report, to whom to report, level of aggregation, interaction between financial reporting and the users of accounting numbers have been classified by some writers as sub-areas of accounting research on reporting. Disclosure has been a significant accounting research problem, which attracted researchers' attention. Except for the two studies on reporting undertaken for post-graduate studies in the field of accounting, the accounting communication has not been highlighted as a problem area in Sri Lanka.

1.2 STATEMENT OF THE PROBLEM

The main objective of a stock exchange is to provide facilities for long-term capital formation of public listed companies through the primary and

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secondary market activities. Price mechanism is used for allocation of funds among the listed companies. More efficient companies should get capital at lower cost. Cost of capital has to be higher for low efficiency companies. Reasonable fluctuations in share prices should determine the allocation of funds. Prompt supply of factual information and its accessibility in the market would maintain price variations within reasonable limits. These are ideal conditions.

In a developing country like Sri Lanka, these conditions may be less effective. Preliminary examinations carried out on the market through observations, direct participation in the market as a buyer and a seller of shares, discussions with the speculators and other actors of the market, review of selected annual reports, inspection of the Stock Market Daily and Facts and Figures supplied by the Colombo Stock Exchange have revealed existence of anomalous characteristics in the Colombo share market. A list of anomalous characteristics observed in the process is given below.

1. Abnormal profits could be gained from the primary and secondary market activities.

2. Irrational price fluctuations of shares on the basis of rumors could be observed in the absence of publicly disclosed factual figures.

3. Some company share prices fluctuate at a relatively high percentage.

4. In some companies, at the time of right issues or bonus issues, abnormal increase in share price could be observed.

5. Low earning yields and high price earning ratios could be observed in the market.

6. A statistically significant difference has been observed between the market value of shares and the balance sheet value of shares.

7. A considerable number of companies appearing in the Stock Market Daily has not earned profit during the previous year.

8. Delistings and suspensions of companies could be frequently seen in the Stock Market Daily.
9. Technical analysis is more predominant than the fundamental analysis. Most of the non-institutional actors interviewed did not consider information given in the financial statements for their decision making.

10. Loss of investments of some new subscribers has shaken the confidence of the investors.

11. Failures of some finance companies in the recent past have led to loose confidence on company directors.

12. Directors and executives of some listed companies have expressed their reluctance and objections to provide company annual reports for research purposes.

13. Misinformation and breach of company law requirements have been discovered in some annual reports by the academics.

One of the main causes for anomalous characteristics prevailing in the stock market may be the gap between the current disclosure practice of accounting information in the annual reports and the disclosure requirements of accounting information of the shareholders and other users. There is no formalized acceptable monitoring procedure in Sri Lanka to verify compliance with the statutory and regulatory requirements of disclosure of accounting information in annual reports.

1.3 OBJECTIVES OF THE STUDY

This study consists of four objectives. The main objective is to expand our knowledge of the overall extent of company annual report disclosure of publicised major companies listed with the Colombo Stock Exchange. Understanding of the prevailing disclosure practice is significant for finding solutions to the disclosure problem. Evaluation of the actual disclosure practice of accounting information in annual reports in comparison to the required disclosure of accounting information of annual reports is the second objective. The degree of supplying required accounting information is measured under the second objective.
The third objective is to examine the change in disclosure practice of accounting information in annual reports during the five-year period from 1994/95 to 1998/99. The variation in disclosure level of accounting information during the five-year period is statistically analyzed. In addition, the change in disclosure of accounting information in relation to the change in assets during this period is examined. Accounting researchers have discovered relationships between certain company characteristics and the disclosure of accounting information in annual reports. The fourth objective of this study is to examine the relationship between the disclosure of accounting information and selected three company characteristics. Total economic resources, value gap between the par value and average market value of ordinary shares, and earnings margin of public listed companies of the Colombo Stock Exchange are the three selected company characteristics. The second, third, and fourth objectives are achieved by testing five null hypotheses.

1.4 NULL HYPOTHESES

First Hypothesis:

“There is no significant difference between the required accounting information of a share market and the disclosure of accounting information by publicised major companies listed with the Colombo Stock Exchange.”

Second Hypothesis

“There is no significant improvement in the disclosure practice of accounting information in the annual reports of publicised major companies listed with the Colombo Stock Exchange in relation to increase in the value of total assets between the period of two financial years from 1994/95 to 1998/99.”
Third Hypothesis

“There is no significant positive relationship between the disclosure of accounting information and the total economic resources of publicised major companies listed with the Colombo Stock Exchange.”

Fourth Hypothesis

“There is no significant positive relationship between the disclosure of accounting information and the value gap between the par value and average market value of ordinary shares of publicised major companies listed with the Colombo Stock Exchange.”

Fifth Hypothesis

“There is no significant positive relationship between the disclosure of accounting information and the earnings margin of publicised major companies listed with the Colombo Stock Exchange.”

1.5 JUSTIFICATION OF THE PROBLEM

The attempt to examine and understand the prevailing disclosure practice of accounting information in annual reports would highlight the weaknesses prevailing in the current disclosure practice, which may lead to explore possibilities for modification and improvement. Disclosure problems in different countries may have common characteristics and may vary from country to country according to the heritage and business culture. South Asian countries have a common heritage. Medium of business communication is English. Accounting, reporting and capital market activities are based on the British traditions. The results of this study in cultural environment of Sri Lanka could provide insight to understand similar problems in other South Asian countries. The disclosure items compiled in the process are user oriented. This study could be used by the
shareholders and their professional advisors to identify their requirements for
decision making and to understand the prevailing level of disclosure. This may in
turn lead to increase shareholders' awareness on disclosure in annual reports.

Company directors who are responsible for presentation of annual
reports could utilize the results of this study to recognize the needs of the users of
accounting information at international level and the current practice of disclosure
in Sri Lanka. They can review the costs and benefits involved in presenting
accounting disclosure items to improve the standard of annual reports.

Professional accountants of the industrial and commercial sector are
involved in incorporating disclosure items in the annual reports. Professional
accountants practicing in audit firms are responsible for expression of independent
professional opinion on financial statements. The model of disclosure items
developed on international setting would provide some insight to professional
accountants of audit and non-audit sectors.

The Securities and Exchange Commission is responsible for the
development of the capital market. The Colombo Stock Exchange is bound for
operation of the share trading floor and improvement of the securities market in Sri
Lanka. The compiled index of disclosure items and variation in current disclosure
practice examined in the study would enable them to acquire new motif to improve
the current communication system in annual reports.

The Accounting Standards Committee is responsible for developing
Sri Lanka Accounting Standards. Accounting and Auditing Standards Monitoring
board is authorized with the monitoring and implementation of accounting
standards. This study will reveal the level of prevailing disclosure practice among
listed companies of Sri Lanka. In addition, the Accounting Standards Committee could observe the current practice to prescribe further improvements in disclosure.

The experts, and other responsible officers of the government departments involved in formulation, drafting, and implementation of the Companies Act could examine the degree of disclosure practiced by the public listed companies. All the disclosure items required to be disclosed under the Companies Act are included in the list of disclosure items. Therefore, inference of the study could be useful.

Since 1961, the disclosure in annual reports has been a special area of research interest. Perusal of the academic research interest through the Internet has shown that many academics consider disclosure of information as a special research area. This study on disclosure of accounting information in annual reports of a small developing country with a population of 18 million and British colonial heritage could make some contribution for the academic attention.

1.6 SCOPE OF THE STUDY

Population of the study is the annual reports of public companies listed for share trading purpose and displayed on the main board of the Colombo Stock Exchange. Annual reports of companies appearing on the second and third boards are excluded from the study.

Quarterly reports, half-yearly reports, prospectuses, and circulars issued by the listed companies contain accounting information. However, they are not part of this study.

Some writers have used main headings such as financial, management, technical and etc. to incorporate different groups of accounting disclosure items. It is possible to include accounting items under other headings. In
this study, accounting disclosure items have been contemplated on the basis of
definition of accounting by academic and professional authorities.

Most of the accounting information items appearing in an annual
report are products of the double entry system. The companies produce some
accounting information extraneous to the double-entry system. Accounting
information items produced extraneous to the double-entry system and considered
by researchers as ought to be disclosed in annual reports are included in the study.

Accounting data are limited to the financial years of public listed
companies commencing from 1 April 1994 and ending at 31 march, 1999.

Weights are assigned to disclosure items on the basis of opinions of
the practicing chartered accountants and students of the Institute of Chartered
Accountants of India. However, their opinions are not solicited in compiling the
accounting information disclosure items.

The developed disclosure items may contain particulars required to
be disclosed under the International Accounting Standards or/and Sri Lanka
Accounting Standards. However, this study does not examine the implementation
aspect of the Accounting Standards.

1.7 DEFINITIONS

Researchers have introduced different terminology to identify
similar concepts with or without slight variations. According to Perry “Definitions
adopted by researchers are often not uniform, so key terms are defined to establish
positions taken in the Ph.D. research.”9 Five definitions are introduced in this
section.

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9 Perry, Chad; "How to Write a Doctoral Thesis -- Ph.D./D.Phil."; [http://www.imc.org.uk/imc/news/
occpaper/epindex.htm]; Last Update; November 28, 1996, p. 4 of 20.
PUBLICISED MAJOR COMPANIES

Public companies listed in the Main Board of the Colombo Stock Exchange are defined as publicised major companies. Companies listed in the Second Board and Third Board are not included.

FINANCIAL STATEMENT INFORMATION AND NON-FINANCIAL STATEMENT INFORMATION

Accounting information given in the Balance Sheet, Income Statement, Cash Flow Statement, and Measurement and Valuation (Notes) of an annual report is defined as financial statement information. All other accounting and accounting related information given in an annual report is defined as non-financial statement information.

STANDARD SCORE

Standard score is a predetermined weighted value allocated to a main item of disclosure and it varies between 1 and 4. There are 78 standard scores for 78 main items.

APPLICABLE DISCLOSURE

Accounting information may vary according to the type of transactions, characteristics, and environment of a company. The accounting information ought to be produced and possessed by a company is defined as applicable disclosure. A company may or may not disclose applicable information items in the annual report.

ACTUAL DISCLOSURE

The accounting information actually disclosed in an annual report is defined as actual disclosure.
1.8 METHODOLOGY

Prior to discussion of methodology of the study, it is worth quoting a statement from Burke.¹⁰

The broad function of accounting is the conveying of empirical financial information to interested parties. Empirical information still needs the test of truth, corroboration, or confirmation applied to its reported observations. We need to determine when accounting propositions are acceptable. Such acceptability needs to be considered within the framework of scientific inquiry in general. It would be naïve to accept descriptions of generally accepted accounting practice as true simply because it appears to be verified by a significant number of accountants.

Accounting information presented in annual reports of public listed companies is prepared and verified by a number of professionally qualified accountants. However, application of scientific inquiry is significant for improvement of the knowledge in the subject area.

This study is one more step of research undertaken by the researcher on disclosure of information by the listed companies in Sri Lanka. Population of the study is the annual reports of public listed companies. Two hundred and forty company names appearing in the Stock Market Daily as at 31 March 1999 was used to select the sample companies. The selected area of sampling was probability sampling. In 1999 the Colombo Stock Exchange had classified listed companies into 16 sectors. In order to obtain representation from

the diversified sectors of the population, the stratified random sampling method of the probability sampling was applied. The number of companies of a sector had varied from minimum of 5 to maximum of 43. The grand total sample size was decided as 10%. The sixteen sectors were reclassified into six by using prevalent characteristics of the companies. Bank, Finance, Insurance, and Investment Trusts (1); Beverage, Food, Tobacco, Chemicals and Pharmaceuticals (2); Construction, Engineering, Land and Property (3); Footwear, Textiles, Manufacturing, Oil Palm and Plantations (4); Hotels and Travels (5); and Motors, Stores and Supplies, Trading, Services, and Diversified Holdings (6) were the classified six groups for the study.11

Proportional allocation was applied in selecting the sample units from each of the stratum. In order to obtain latest 5 years annual reports, sample companies were not selected from the companies listed after the financial year 1994/95. The net increase of the number of companies after the financial year 1994/95 is 14. The selected sample units representing each stratum of the population is given in the TABLE 1 – 1. Lottery method was used in selecting sample companies in order to provide equal opportunities for all the applicable companies. Folded chits were prepared for each of the company incorporating the group number and the company name. They were placed in six containers, separately, according to the group numbers.

11 Companies in the Banking and Finance area are included in this study. However, researchers such as Ahmed & Nicholls (1994, p. 67), Hossain et al. (1994, p. 340), Wallace et al. (1994, p. 43), Owusu-Ansah (1998, p. 617) had excluded Banking and Finance companies from their studies.
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Each container was thoroughly reshuffled prior to each draw. Draws were continued until the sample of the required size was obtained. Sampling without replacement procedure was used. Selected chits were not returned to the container from which they were selected.

Different methods were used in collecting annual reports of sample companies of the five financial years from 1994/95 to 1998/99. Extra copies of required annual reports available at the Institute of Chartered Accountants of Sri Lanka were collected. Writer gathered the Annual reports available in the Department of Accountancy and Financial Management of University of Sri Jayewardenepura. Letters were written to chief accountants of the sample companies requesting for annual reports of the financial year 1998/99. Most of the companies responded to the request by sending their annual reports by post. Some company accountants were personally contacted and relevant annual reports were obtained. Missing annual reports were photocopied from the library of a share
broker company. The list of annual reports of sample companies participating in the study is given in the SCHEDULE - A. Hundred and twenty annual reports of twenty-four companies for the latest five financial years ending 31 March 1999 were collected for the study.12

As a preliminary facilitation to the study, an index of accountancy journals published in English language was compiled. The index consisted of 97 academic (55) and professional (42) accountancy journals. This does not mean that accountancy articles appear only in accountancy journals. Research articles relevant to accountancy could be found in social science, economics, management, finance, and commerce journals.

By reference to research articles relevant to disclosure of company information, a card index of 741 research articles, monographs, and Ph.D. dissertations on disclosure was compiled. Copies of 3 Ph.D. theses, 2 monographs, and 396 journal articles on the subject of disclosure of accounting information were collected. The library facilities of University of Sri Jayewardenepura, Colombo University, Kelaniya University, Peradeniya University, Open University of Sri Lanka, Post-graduate Institute of Management in Sri Lanka, Institute of Chartered Accountants of Sri Lanka, Sri Lanka Branch of the Institute of Chartered Management Accountants, Sri Lanka Institute of Development Administration, Ottawa University, DBA Marathwada University and Colombo Stock Exchange were used for the purpose. Some copies of Ph.D. theses were referred, but not collected due to unavoidable reasons. Finally, one hundred and forty-three research materials were used for the study.

12 In the case of one company the latest published annual report is 1997/98. Its annual reports are collected commencing from the financial year 1993/94 to have five annual reports of the latest years.
For this study, data had to be collected on disclosure of accounting information in annual reports, total value of economic resources of companies displayed in the annual reports, value gap between the market value and par value of ordinary shares, and earnings margin computed from the information given in the annual reports.

The final computed data on disclosure of accounting information consisted of total applicable disclosure scores, total actual disclosure scores, and total disclosure percentages. A disclosure index had to be prepared to select, collect, and measure basic data on disclosure of accounting information from annual reports. Since 1961, most of the researchers on disclosure had applied indexes of disclosure to measure the level of disclosure in annual reports. Opinion surveys of users/ preparers of annual reports or legal requirements and rules of stock exchanges or international and national accounting standards or combination of those or compiling an index on the basis of indexes developed for previous studies had been the methods, generally, applied in developing a disclosure index. In this study, the level of disclosure in annual reports was measured on the basis of international settings. The most appropriate method to apply requirements of international users was to use indexes developed by different researchers in different country studies by applying different methods. In this study, a disclosure index was compiled, by applying indexes developed during the period between 1974 and 1997. All disclosure index items developed during the period between 1961 and 1971 had been incorporated in 1974 disclosure indexes. The list of disclosure items developed by Stanga (1974, pp. 138-140), Chandra (1974, pp. 738-740), Buzby (1974, p. 434), McNally et al. (1982, p. 19), Jawahar Lal (1985, pp. 196-203), Chow and Wong-Boren (1987, p.537), Wallace (1988, pp. 357-361),
Tai et al. (1990, p. 108), Cooke (1991, p. 178), Courtis, (1992, pp. 36-37), Hossain (1994, pp. 348-350), Botosan (1997, p. 332) were used to compile the disclosure index of this study. A separate card was prepared for each disclosure item appearing in a disclosure list, and the cards were organized and kept according to chronological order. Repetition cards and cards not relevant to disclosure of accounting information were removed from the card index. Basically, cards were sorted into financial statement accounting information cards and non-financial statement accounting information cards. Financial statement accounting information cards were classified into four groups as Balance Sheet, Income Statement, Cash Flow Statement, and Measurement and Valuation. Non-financial statement accounting information cards were sorted into 10 groups as Value Added Statement; Quantity Accounting Items; Historical Information; Estimates for Future Expectations; Human Resource Information; Social Responsibility Accounting; Share Market Information; Management Review and Auditors’ Opinion on Accounting Information; Information on Ratios; and Graphical, Specified, and Accounting Related Information. The overall classification had 14 group items of disclosure. Some of previous researchers, e.g. Chandra = 6 (1974, pp. 738-740), Stanga = 3 (1975, pp. 138-140), Jawahar Lal = 6 (1985, pp. 196-203), Wallace = 3 (1988, pp. 357-361), Cooke = 7 (1991, p.178), Courtis = 3 (1992, pp. 36-37), Hossain = 8 (1994, pp. 348-350), Botosan = 5 (1997, p 332) had classified disclosure items into groups. However, Buzby (1974, p. 434), McNally et al. (1982, p. 19), Chow and Wong-Boren (1987, p. 537), Tai et al. (1990, p. 108) did not have such classifications.

Accounting information cards relevant to accounting policies were included in the Measurement and Valuation group.
Titles of the accounting disclosure item cards were carefully examined and edited to exclude inconsistency, duplication, and unsuitable presentation. Under each group item, accounting disclosure items were rearranged as main items and sub-items. Sub-items were elements of main items. Most of the main items had sub items. However, some main items did not have sub-items and some sub-items did not have main items. The missing titles of main items and sub-items were coined by reference to the Sri Lanka Accounting Standards. There were 78 main items under the 14 group items of accounting information. Three hundred and forty (340) sub-items were spread among 78 main items of accounting information.

The Preliminary Data Sheet (SCHEDULE – C) was used to manually record existence or non-existence of applicable sub-items of disclosure in annual reports. A separate Preliminary Data Sheet was maintained for each of the five financial years. There were 5 Preliminary Data Sheets. The Preliminary Data Sheet consisted of horizontal rows for main items and sub-items and 24 vertical columns for 24 company annual reports of a year, and 2 columns, one for item numbers and the other for description of disclosure items. Seventy-eight main items and 340 sub-items were listed in the Preliminary Data Sheet. The square space (cell) created by intersection of a horizontal sub-item row and a vertical company column was used to enter the relevant disclosure data of a sub-item. The existence or non-existence of information in the annual report of an applicable sub-item was entered in the relevant sub-item cell. No entries were made in main item cells.

The data entry procedure in the Preliminary Data Sheet was as follows. An annual report was read twice very carefully. At the first reading the
applicable accounting information and actual accounting information were observed and identified. At the second reading of the annual report, data were entered in the relevant cells of sub-items. If a sub-item was applicable to the company and disclosed in the annual report the 'X' sign was entered in the relevant company annual report sub-item cell. If a sub-item was applicable to the company and not disclosed in the annual report the '0' sign was entered in the relevant company annual report sub-item cell. If a sub-item was not applicable to the company and not disclosed in the annual report, the relevant company annual report sub-item cell was kept blank. The main item rows were used only to organize sub-items in the Preliminary Data Sheet. If sub-item cells of a main item relevant to a company did not contain any data the main item and its sub-items were marked and cancelled.

The Score Allocation Sheet (SCHEDULE – D) was used to enter disclosure values (numbers) of sub-items, and to compute values of main items, group items and summary disclosure items. The Score Allocation Sheet was an electronic spreadsheet. The rows, columns, cells, numbers and labels of the Preliminary Data Sheet were incorporated in the Score Allocation Sheet. Additional rows and columns were inserted for calculation and processing of data. A column was inserted next to the description column to record Standard Disclosure Scores of main items. A main item of disclosure consisted of two rows, one for the applicable disclosure score and the other for the actual disclosure score. Rows for fourteen group disclosure items were inserted to the spreadsheet. Each group disclosure item consisted of two rows, one for the applicable disclosure score and the other for the actual disclosure score. Rows for three summary disclosure item scores, non-financial statement disclosure score, financial
statement disclosure score, and total disclosure score were incorporated. Each summary disclosure item consisted of three rows. The bottom row was for the actual disclosure score. The middle row was for the applicable disclosure score. The top row was for the disclosure percentage. A separate Score Allocation Sheet was maintained for each of the five financial years, so there were five Score Allocation Sheets.

'X' sign and '0' sign data of disclosure entered in the Preliminary Data Sheet had to be converted to numeric data in the Score Allocation Sheet for further processing. A data conversion table was prepared for the purpose. The unweighted applicable main item value was one. The maximum unweighted actual main item value was one. The minimum and maximum numbers of applicable sub-items of a main item were considered as 1 and 11, respectively. The data conversion table is given in TABLE 1-2. The row one gives the number of applicable sub-items of disclosure. The number of applicable sub-items of disclosure could vary between 1 and 11. Scores to be allocated for each sub-item under a main item are given in each of the columns. If the number of applicable sub-items under a main item is 11 the figures in the last column have to be used. If the number of applicable sub-items under a main item is 3 the figures in the third column have to be used. The total number of 'X' and '0' signs in sub-item cells under a main item in the Preliminary Data Sheet is the number of applicable sub-items of the main item. The '0' sign data appearing in the Preliminary Data Sheet are entered in the relevant sub-item cells of the Score Allocation Sheet as zero values. The 'X' sign label data appearing in the Preliminary Data Sheet are converted to values by applying the figures available in the relevant sections of the
Data Conversion Table and entered in the relevant sub-item cells of the Score Allocation Sheet.

**TABLE 1-2**

**DATA CONVERSION TABLE FOR APPLICABLE SUB-ITEMS**

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</thead>
<tbody>
<tr>
<td>1</td>
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<td>0.34</td>
<td>0.25</td>
<td>0.20</td>
<td>0.17</td>
<td>0.16</td>
<td>0.12</td>
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<tr>
<td>0.05</td>
<td>0.33</td>
<td>0.25</td>
<td>0.20</td>
<td>0.17</td>
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<td>0.33</td>
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</tbody>
</table>

If a main item consisted of 5 applicable sub-items, of which 3 were disclosed and 2 were not disclosed, the value of zero was entered in the relevant cells of the Score Allocation Sheet to record sub-items not disclosed. The value of 0.20 was entered in the relevant 3 cells of the Score Allocation Sheet to input disclosed sub-items, providing a total value of 0.60 for the main item actual score cell.

A main item of a company consisted of two data cells. One was for the actual disclosure score and the other was for the applicable disclosure score. The values of the sub-items were aggregated in the actual disclosure score cell of the main item. This was an unweighted value, which was one or less than one. Unweighted value of the applicable disclosure score cell of a main item was one. Both of these unweighted values were converted to weighted values.

Main items of disclosure may not have equal importance to users of accounting information. However, researchers such as JawaharLal (1985, p. 105), Wallace (1988, p. 355), Cooke (1989, p. 115; 1991, p. 179; 1992, p. 233), Kamran and Nicholls (1994, p. 68), Hossain et al. (1994, p. 341) had assigned equal scores to every item of disclosure under the assumption that they were equally important.
Most of the users of accounting information give preference to disclosure items at different levels. Cerf (1971, in Jawahar Lal, p. 82), Buzby (1974, pp. 429-430), Stanga (1974, p. 70), Firth (1979, in Jawahar Lal, p. 99), McNally (1982, p 12), Chow and Wong-Boren (1987, p. 535), and Wallace et al. (1994, p. 44) had weighted the items of disclosure on the basis of their relative importance. In this study, main items of disclosure were weighted prior to further processing. The levels of weight applied by different researchers had varied. Cerf (1961) and Singhvi (1971) had used 1 – 4 levels; Buzby (1974) 0 – 4 levels; Stanga (1974) 2 – 4 levels; Gyan Chandra (1974), Michael Firth, and McNally et al. 1 – 5 levels; and Chow and Wong-Boren (1987) 1 – 7 levels. In this study 1 – 4 levels were applied. In providing weights for disclosure items, opinions of different types of users such as financial analysts, security analysts, investment analysts, practicing accountants, and etc had been used by the researchers. In this study, opinions of 5 practicing chartered accountants and 5 students of the Institute of Chartered Accountants of India undergoing practical training in audit firms were utilized to calculate weights. An ‘Evaluation Schedule’ (SCHEDULE – B) containing main disclosure items was prepared. In couple of instances, where the headings of the main items were not sufficiently comprehensive, titles of their sub-items were included in the ‘Evaluation Schedule’. Participants were requested to identify each of the main items of disclosure as Essential or Very Important or Important or Not Important and weights were allocated by the writer as 4, 3, 2, and 1, respectively. The researcher was personally involved in collection of data. The weighted average values were computed for each of the main items of disclosure and were labeled as Standard Disclosure Scores. The Standard Disclosure Scores were entered next to main item headings in the relevant cells of the standard score column. The value
‘1’ appearing in an applicable main item cell was multiplied by the related ‘Standard Score’ to calculate the weighted applicable score of a main item. The aggregated value of sub-items appearing in an actual main item cell was multiplied by the related ‘Standard Score’ to calculate the weighted actual score of a main item. Formulas entered in the applicable main item cells and actual main item cells were utilized for the calculation purpose. Weighted Standard Disclosure Scores and Weighted Actual Disclosure Scores were calculated for main items of 120 annual reports of 24 sample companies for five years. A separate Score Allocation Sheet was maintained for each of the years.

Actual disclosure scores of main items were aggregated in relevant group item actual cells. Applicable disclosure scores of main items were aggregated in the relevant group item applicable cells. The computed data values appearing in the 10 group item actual cells under the non-financial statement category were aggregated in the non-financial statement actual disclosure score cells. The computed data appearing in the 10 group item applicable cells under the non-financial statement category were aggregated in the non-financial statement applicable disclosure score cells. The computed data values appearing in the 4 group item actual cells under the financial statement category were aggregated in the financial statement actual disclosure score cells. The computed data appearing in the 4 group item applicable cells under the financial statement category were aggregated in the financial statement applicable disclosure score cells. The two computed values in the non-financial statement actual disclosure score cell and financial statement actual disclosure cell were added together in the total actual disclosure score cell. The two computed values in the non-financial statement applicable disclosure score cell and financial statement applicable disclosure score
cell were added together in the total applicable disclosure score cell. These calculations were carried out for all the annual reports. Three summary disclosure percentages were calculated for the non-financial statement disclosure, financial statement disclosure, and total disclosure. Following formulae was applied to calculate percentages with appropriate substitutions.

\[ DSP = \frac{ACDS}{APDS} \times 100 \]

DSP = Disclosure Score Percentage

ACDS = Actual Disclosure Score

APDS = Applicable Disclosure Score

Disclosure score percentages were also calculated at the bottom of the spreadsheet for group item scores by applying the same formulae. All the formulas were entered into relevant cells for calculation purposes.

The disclosure practice of accounting information was examined and analyzed by using 340 sub-items, 78 main items, 14 group items, and 3 summary disclosure percentages. Percentage analysis was used to examine sub-items of disclosure. Descriptive statistics were applied for main items, group items, and summary items of disclosure. The procedure of analysis is described in the part one of chapter 5. For testing of the 5 hypotheses, Student t test, correlation, and regression analysis were used. In the case of second hypothesis in addition to correlation and regression analysis, descriptive statistics was applied. The methodology involved in testing of the hypotheses is described in part two of chapter 5.

1.9 OUTLINE OF THE REPORT

The second chapter of the study contains review of previous studies on disclosure in annual reports of public companies, undertaken by different
researchers during the period from 1948 to 1999. Chapter 3 is a theoretical study on disclosure of accounting information in annual reports of companies listed at a stock exchange. Chapter 4 is allocated for the Colombo Stock Exchange and capital formation of public listed companies in Sri Lanka. Chapter 5 consists of two parts. The part one examines the disclosure practice of accounting information in annual reports of publicised major companies listed with the Colombo Stock Exchange. In the part two, five hypotheses relevant to the disclosure practice of accounting information in the annual reports are statistically tested. Chapter 6 deals with the summary, conclusions, and suggestions including further issues for studies on disclosure of accounting information.