## CHAPTER - I

## INTRODUCTION

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INTRODUCTION

The primary function of accounting is recording of economic data of a business enterprise and to facilitate the administration of its financial activities. It has to measure the economic activity, i.e., employment of its assets for profit, and to disclose it in the financial statements and reports of the financial aspects of the activities of the enterprise for a particular period. In other words, it is required to show the manner in which its funds have been utilized during that period and stand as at a definite date.

Such information is largely supplied by means of periodical statements and reports at the end of each accounting period. Thus, all the activities of a business enterprise have to be made known to the shareholders, who contribute towards the share capital, which is the main source of funds and who are the real owners of the business enterprise and to others such as customers, debenture holders, financial institutions, etc, who are interested in the profitability and long term solvency of the corporate enterprise. Thus, concerned people can develop their own attitude towards the organization and also can review their perception about the firm on the basis of the information communicated to them through financial statements and reports periodically.

The transformation of joint stock companies from just legal business entities to socio- economic institutions has evoked the interest of various sections of the society in knowing working results and financial structure of companies. The
reporting of economic success or failure of the economic units, which control and use the substantial portion of the scarce capital resources of the country, can satisfy these interested groups.

Reporting is nothing but the communication of accounting information of an entity to a user or group of users.

If accounting is recognized as an information and communication system, it would seem that the five components of such a system, viz., sender, message, channel, receiver and monitor, could be applied to accounting. According to Harold and Langenderfer\(^1\) (1973), these components might be related to a “financial reporting or disclosure system” in the following manner:

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<td><strong>Sender</strong></td>
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The relationship between these components of ‘corporate disclosure system’ is presented in Figure 1.1.

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MEANING

The main purpose of corporate financial reporting is to produce information that is true and relevant. A report is reasonably expected to rightly hold the reflection of the economic consequences of a company’s operations.

Financial reporting is a communication of published financial statements and related information from a business concern to outsiders. Company’s financial reporting is a total communication system involving the company as issuer, the investors and creditors as primary users, other external users, the accounting profession as measurers, auditors and the company law regulators as administrative authorities.

**Figure 1.1**

*Corporate Disclosure System*

Corporate financial reporting (CFR) is a kind of communication system between an entity and its target audience. It has been described as instrumental for social integration that brings the enterprise and the interested parties together. In the process, the company has to disclose the relevant data and information to serve the intended purpose.

The CFR is a comprehensive package of various kinds of information, which suitably describes a company’s economic operations. In the opinion of the FASB, financial reports should include not only financial statements but also other means of communicating information relating directly or indirectly to the enterprise’s resources, obligations, earnings, etc.

Whether the top management is constituted by a team of persons from among the majority shareholders or whether it is constituted by a team of professional experts functioning on behalf of the controlling group, the quality and extent of disclosure will always be circumscribed by the overpowering motivation to obtain the approval of the shareholders’ and retain the control of affairs. Financial reporting essentially therefore is the disclosures about the performance of top – management by the top-management. And hence an element of human bias will certainly be prevalent in financial reporting.

Financial report is a means through which directors seek and the shareholders extend or refuse their confidence to them every year.
DEFINITIONS

"... The financial reporting should have qualities like, decision usefulness, benefits and costs, relevance, reliability, neutrality, verifiability, representational, faithfulness, comparability, timeliness, understandability, completeness, consistency and materiality" (Financial Accounting Standards Board, 1979).2

"Corporate reporting is a variable, to be adjusted or manipulated by management in support of its strategies and goals, subject to whatever statutory disclosure constraints exist. The operational objective in regard to reporting is presumably, to influence or manipulate investor reactions, sustain a satisfactory share price and raise capital on cheapest and most advantageous terms" (Wagy Shankas, 1982).3

Kohler’s dictionary for Accountants defines it as, “an explanation, or exhibit, attached to a financial statement, or embodied in a report (e.g., auditor’s report) containing a fact, opinion or detail required or helpful in the interpretation of the statement or report.”

Chetkovich 4 (1955), who defines it as that aspect of financial reporting which has to do with the presentation of descriptive or supplementary data, as distinguished from the general form of the financial statements.

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Disclosure is the movement of information from the private domain (i.e., inside information) into the public domain (AAA, 1977).5

“It is the process through which an enterprise communicates with the outside world” (Gyan Chandra, 1974).6

“It means the communication of material and relevant facts concerning financial position and the results of operations of the reporting concern to various users” (Meigs & Johnson, 1977).7

FRAMING UP A FINANCIAL REPORT

Theoretically the preparation of a financial report in an organization in a changing environment follows a path, which may be described in this way- (Baker & Haslem, 1973).8

a) A change in environment influences interested user groups.

b) This change appeals to the conceptual framework for interpretation of the relevant problem.

c) The users then demand for a particular kind of disclosure; and

d) The financial report is the final outcome of the interaction between specific demand and the conceptual framework.

This act of influence and interaction culminating into a financial report may be better expressed with the following Figure 1.2

**Figure 1.2**

**Framing up a financial report**

ANNUAL REPORT

In the sixteenth century the summary of the accounts was made an integral part of the ledger in the form of a balancing account with the word ‘Dr’ and
‘Cr’. This balancing account was looked upon merely as a proof of the bookkeeper’s work and no care was exercised to present a clear showing of financial position.

This balancing account, with the establishment of large business having a large number of investors (shareholders) during the later part of the 19th century, developed into the contemporary balance sheet, but it lacked uniformity, terminology and classification of items.

The form of balance sheet (voluntary basis) called as uniform sheet was first of all prescribed in U.K in 1856. In India, the beginning was made a year later, i.e., in 1857 (adoption being on voluntary basis).

There are many media adopted by the companies for dissemination of information to outsiders. These include, prospectus, press releases, statutory reports, interim reports, financial dailies and magazines interviews between management representatives and the professional financial analysts and the published accounts; i.e., the ‘Annual report’. Of all these media, annual report is the most significant channel of disclosure. It is the prime medium for projecting a company at its audience and is the most effective voice in corporate communication (Haggie, 1984).9

An annual report is most direct, least expensive, most timely and fairest method of reaching all shareholders and other present or potential investors. It is to

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the annual report as a whole that one must look for the discharge of the managements’ responsibility to its stakeholders (Duff and Phelps, 1976).10

An annual report, generally contains chairman report, director’s report, balance sheet, profit and loss account, auditor’s report, statistical, historical summary and other statements providing quantitative and qualitative data which may aid the users in their decision making.

Hay,11 (1955); Horngren,12 (1957); Rusch,13 (1975); and Lee and Tweedie,14 (1977), in their studies, have revealed that the corporate annual report is an important source of information and is the single document which is used by a majority of the shareholders and other users.

Annual report is treated as a valuable source of information to the shareholders and other users, mainly because:

1. Annual report, being the audited document, provides authentical information about the issuing entity.
2. It is relatively more easily accessible than any other source of information.
3. Annual report is the single document, which contains besides financial statements, some other valuable information such as, highlights of the year, historical data, significant performance ratios, accounting policies, segmental

information, employees welfare activities, company's present and future policies, social reporting, etc, which is not provided by any other single medium.

TYPES OF ANNUAL REPORTS

There are usually two types of annual reports. They are:

I. Abridged annual reports.

II. Detailed annual reports.

I. ABRIDGED ANNUAL REPORTS

Abridged annual report has been a reality. Suitable amendments to companies Act to publish abridged reports enabled many of the companies to avail of such facility. Of course shareholders' right to demand detailed annual report remains protected even with these amendments.

Those who advocate and publish abridged annual reports argue that the cost of detailed annual report is mounting year after year and becomes unproductive. The present study of the researcher has reveals that only 5 percent of the shareholders care to look at such reports with interest. Except this perhaps there is no other justifications for abridged reports.

II. DETAILED ANNUAL REPORTS

Certain changes in business, corporate sector and economy strengthen the case for detailed reports:
The size of business units has grown. Such a change demands companies to disclose their affairs to all concerned.

Even in the absence of abridged reports there remained pressure on companies to disclose more and more material facts in their published reports.

Increase in number of companies, number of shareholders and the funds collected by them recently have created a number of issues with respect to corporate sector and capital market. All these developments and the unimagined developments in the next decade allow some to emphasize as much disclosure as possible in published reports.

The collection of huge funds by the companies in the late 90’s from public including mega issues may create havoc in the economy if these are misused or mismanaged. These trends led to the publishing of quarterly reports, which was made compulsory recently. In the very near future publishing of monthly reports will be possible.

The interested groups in the corporate sector are many. These groups need more and more information from the corporate sector. The only way to do so is to offer them detailed annual reports.

In the view of what is stated above and as an abridged report has to stay with us, it is safe to recommend that:

(a) Detailed reports must be available to the shareholders and others on demand within a specified time. It should be mandatory to supply the multiple copies of detailed annual reports to security
exchanges, financial institutions, government authorities and university libraries.

(b) Thanks to information technology, not only detailed annual reports but periodical reports on Internet should be made obligatory.

MODE OF DISCLOSURE

Adequate disclosure demands that the information should be presented in a form, which fosters understandability. Hendriksen\(^\text{15}\) (1984), have pointed out that the method of disclosure determines the usefulness of information, but the question of method is secondary to three other issues in corporate disclosure, viz., users, objectives and quantum.

The selection of method of disclosure depends on the nature of the information and its relative importance. The common method can be classified as under:

i. Form and arrangement of balance sheet and profit and loss account.

ii. Terminology and detailed presentations.

iii. Parenthetical information.

iv. Footnotes and schedules.

v. Supplementary information.

vi. Auditor’s report.

vii. Chairman or president’s letter.

viii. The report of the board of directors.

ix. Charts, diagrams, and

x. Statistical presentation, etc.

Certain non-financial but significant information can be presented in the chairman's / president / director's report. These reports usually include:

a) Non-financial events and changes during the year that affect the operations of the firm.

b) Information about the future plans of the firm, industry trend, etc.

c) Current and anticipated capital expenditure.

d) Information about products and employees.

e) Dividend payments, etc.

The information, which is presented either in the financial statements or supplementary statements or director's report, etc, may also be presented by way of diagrams or charts. This is desired from the point of view of the non-sophisticated users, who cannot understand and interpret the information contained elsewhere in the annual report.

THE CONCEPT OF DISCLOSURE

On the basis of the fact that disclosure of information is significant to external users, it should be fair, full and adequate. There are three concepts of disclosure generally proposed and found in practice.

1. FAIR DISCLOSURE

It implies that the accounting and the other information are unbiased and impartial. Its objective is to provide equal treatment to all the potential financial statement readers.
2. **FULL DISCLOSURE**

It implies, published financial statements and attendant notes should include any economic information related to the accounting entity that is significant enough to effect the decisions of informed and prudent users of financial statements.

3. **ADEQUATE DISCLOSURE**

The task of defining the term ‘Adequate disclosure’ is more difficult because the adequacy of disclosure cannot be tested accurately and precisely since no definitive test to measure it exists in financial reporting and moreover it is a subjective term. In very comprehensive terms, a disclosure can be said to be an adequate disclosure, when it entails the answers of ‘to whom, why, how much, what and when the information to be disclosed’.

**CHARACTERISTICS OF AN EFFECTIVE DISCLOSURE SYSTEM**

The objects of adequate, fair and full disclosure in financial reporting are achieved by ensuring the following characteristics:

1. **RELEVANCE**

Relevance is one of the characteristics of an effective disclosure system, which means that the contents of the report should have some relevance or help the users in making good and sound economic decisions.

2. **CONSISTENCY**

When the principle of consistency is not followed, it will lead to faulty conclusions by the users, as the financial environment is complex. Consistency means
that a uniform system or a particular method of disclosure is followed by an enterprise from one year to another; and no change is made abruptly.

3. **UNDERSTANDABILITY**

   The information in the financial statements should be presented in such a manner that any user of the report can understand it.

4. **COMPARABILITY**

   The information must be comparable, that is, it must be prepared in such a way as to be capable of being compared, realistically with previous or similar information, keeping in mind particularly, that it is designed to aid users, to make decisions, which by definition involve comparisons of alternatives.

5. **MATERIALITY**

   The characteristic feature of materiality implies that only the material information needs to be reported in the financial reports. Material information is that information, which influence the economic decisions of the users.

6. **RELIABILITY**

   The duty of the management to report reliable information is achieved by applying generally accepted accounting principles, appropriate to the undertaking. The information must be fair, that is, it must be measured and reported with as much objectivity and neutrality as possible.

   These characteristic features of the theory of corporate disclosure make the information reported through the financial statements and reports, useful to the users.
SIGNIFICANCE OF DISCLOSURE

Disclosure is significant from the point of view of users, companies and the nation as a whole. It reduces uncertainty in the market and helps the users in selecting the best portfolio for their investments. The companies gain as disclosure stabilizes the prices of their shares. It affects the reallocation of society’s wealth between consumption and investment, and thus, influences the rate of capital formation in an economy.

**Beaver**\(^{16}\) (1981), while discussing the significance of information disclosure, has arrived at the following consequences:

1. Financial information can affect the distribution of wealth among investors.
2. It can affect the aggregate level of risk incurred and can affect the distribution of the risk among the users.
3. It can affect the rate of capital formation in an economy with a resulting reallocation of society’s wealth between consumption and investment.
4. It also affects how investment is allocated among firms. Disclosure may alter investors’ beliefs about the relative rewards and risks associated with particular securities.
5. It can affect the amount of resources devoted to the production, certification, dissemination, processing, analysis and interpretation of disclosures.
6. Financial information involves the use of resources in the development, compliance, enforcement and litigation of disclosure rules.

Financial information can alter the amount of resources used by the private sector to search for non-disclosed information. Corporations have an incentive to provide such information and analysts have an incentive to search for and to disseminate such information.

PURPOSES OF CORPORATE DISCLOSURE

Accounting Standards Steering Committee in its report\(^{17}\) remarked that the objective of corporate reporting is to communicate economic measurements of and information about the resources and performance of the reporting entity, useful to those having reasonable rights to such information.

The concept of adequate disclosure also involves identifying the purpose for which information is to be disclosed. Users and the purpose of corporate disclosure are interlinked. The need to identify the user group(s) goes beyond the need to identify their purposes in using financial data.

Stated below are the significant purposes for which information is to be disclosed nowadays:

i. To provide information useful to investors and creditors for predicting, comparing and evaluating potential cash flows in terms of amount, timing.

ii. To provide information for predicting, comparing and evaluating the earning power of an enterprise.

iii. To supply information useful in judging managements ability to utilize the resources effectively in achieving the primary goals of an enterprise.

iv. To report on those activities of the enterprise which are important in its social environment.

v. To communicate economic measurements of and information about the resources and performance of the reporting entity useful to those having reasonable rights to such information.

vi. To provide adequate, full and fair information to the present and the prospective investors.

vii. To determine liquidity and solvency of an enterprise.

viii. To take timely decisions in the interest of owners.

The True blood committee, which was setup in USA in 1971, recommended 12 objectives in their report in 1973. One of the main objectives is, “The basic objective of corporate financial reporting is to provide information useful for making economic decision”.

The US, Financial Accounting Standard Board (FASB) laid down five objectives in their report in November 1978 of which the most widely quoted one is, “To assist investors and creditors in assessing future net cash flows to the enterprise in respect of amount, timing and uncertainty”.

The International Accounting Standard Committee issued an exposure draft on May 1, 1988 on “proposed statement framework for the preparation and presentation of financial statements”. It states that, “the objective of financial statement is to provide information about the financial position, performance and

changes in financial position of an enterprise that is useful to a wide range of potential users in making economic decisions”.

In India, the recommendations of the Bhaba committee,\(^{19}\) which is also known as company law committee, 1952 was as follows:

“The form of balance sheet and profit and loss account should be such as would make available to the shareholders as much information relating to the affairs of the company as it is possible to disclose”.

There may be many purposes of disclosure as per requirements of different users, but since the investor, is the dominant group, the primary purpose of information in a disclosure to be termed as an ‘adequate disclosure’ is to facilitate investment decisions, yet it should meet the information requirements of others also.

**USERS OF THE CORPORATE REPORT**

The financial accounting information is used by a variety of groups and for diverse purposes, some users have direct interest in reported information and the others have an indirect interest in it. Thus, users information requirements differ. The interests involved of the various users of the corporate report are:

**SHAREHOLDERS**

The shareholders come last of all in respect of safety of their funds but they have the most vital interest, since their well being depends on the well being of the company.

A good rate of return means that the shareholders have not much to fear.

\(^{19}\) Report of Company Law Committee (Bhabha Committee), Govt. of India, 1952.
BANKERS / LENDERS

The bankers and other lenders are usually interested in the liquidity, profitability of the company and debt-service ability, etc. They are usually interested in cash flow information and long-term solvency position of the firm.

CREDITORS / SUPPLIERS

Creditors and suppliers are interested in the current ratio and acid test ratio information, regarding repayment of their dues in due time. In short, they are interested in the short-term solvency position of the company.

PRESENT AND PROSPECTIVE INVESTORS

This group is interested to analyse the safety and return of investment.

CUSTOMERS

Customers expect better quality of products, price and continuation of the company.

EMPLOYEES

This group is interested in stability and profitability of the company. They expect high level of remuneration, good working conditions, retirement benefits, service security, etc.

GOVERNMENT AND OTHER AGENCIES

These parties are interested in effective utilization of scarce resources, surplus generation, determination of tax and other levies, etc.
They are interested in social benefits, prosperity of the enterprise, etc.

Leach (1975) has made a statement at a press conference, launching the corporate report:

"In recent years there have been enormous changes in public interest in and understanding of financial statements. The informed users of accounts today are no longer solely the individual shareholder but equally the trained professional acting for institutional investors and the financial news media" (As quoted in Lee and Tweedie, 1977)²⁰.

The idea of Cowan²¹ (1968) and True blood committee²² (1973) is almost same in this issue, it states that, "Accounting information should be presented so that it can be understood by reasonably well-informed, as well as by sophisticated users. In effect, presenting information understandable only to sophisticated users establishes a bias".

Chetkovich²³ (1955) occupies an intermediate position and advocates that an annual report should be addressed to a 'standard readers', who lies somewhere in between the sophisticated and unsophisticated users.

Therefore, the companies should prepare a single general-purpose report focusing on the informational needs of the present and the prospective investors.

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²⁰ ibid.
QUANTUM OF INFORMATION

The quantity of the information depends upon the need and expectations of users on the one hand and degree of uncertainty prevailing in decision making on the other hand. In an adequate disclosure, ‘degree of uncertainty in users decision making’ is also considered, while deciding how much to disclose in annual reports. This implies that greater the uncertainty, the greater is the amount of information needed.

The quantum of information to be disclosed in the report is bases on:

a) Legal provisions regarding disclosure, contained in various statutes.
b) Requirement of the stock exchange authorities regarding disclosure.
c) Disclosure standards as lay down by the professional accounting bodies.
d) The requirements of the Bureau of public enterprises (only for public sector).
e) Informational needs of the users, and
f) Willingness on the part of the management to disclose adequate and relevant information.

On the other hand, all possible information relating to a unit cannot be disclosed in financial statements, because that would make financial statements too large, costly and perhaps more confusing. Simultaneously, information, which is material and capable of affecting judgment of external decision makers, must be disclosed. There are two qualitative characteristics for quantum of information to be disclosed.
(i) **RELEVANCE**

Relevance has been treated as the primary qualitative objective of financial accounting information, yet no satisfactory set of relevant items of information has been suggested. Therefore, an important task in this direction is to determine the needs of users and the items of information should be relevant to meet the needs of the users.

(ii) **MATERIALITY**

According to Accounting Standard –1, formulated by ASB, it is required that financial statements should disclose all ‘material’ items, i.e., all those items should be disclosed in annual reports that are likely to influence the economic decisions of users. It is significant to note that some items though very small in size and quantity, may be material because the materiality of an item not only depends upon its relative size but also on its nature or combination of both.

Baker and Haslem, ²⁴ (1973); Buzby, ²⁵ (1974); Gyan chandra, ²⁶ (1975); Chenhall and Juchan, ²⁷ (1977); Benjamin and Stanga, ²⁸ (1977); and McNally, HockEng and Hasseldine, ²⁹ (1982); in their studies pointed out that

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²⁴ ibid, p.64.
different user-groups attach different values to the various items of information, which may be included in an annual report.

Bedford, 30 (1973); Flamholtz and Pyle, 31 (1968); Birnberg and Dopuch, 32 (1963); Rappaport and Lerner, 33 (1969); Mautz, 34 (1968); Davidson, 35 (1969); Parker, 36 (1971); Gyan Chandra, 37 (1975); Lee, 38 (1983); and Casey, 39 (1972), have suggested the expanded disclosures in the annual reports.

TIMELINESS IN REPORTING

Timely reporting is an essential element of adequate disclosure. Responsibility should be fixed to report promptly, accurately and timely the corporate news, which may materially affect values of securities or influence investor's decision. Thus information disclosed under 'adequate disclosure' is current and supplied frequently. Interim report may be supplied for this purpose.

In order to arrive at correct economic decisions, timely financial accounting information is necessary. Any delay in reporting will increase the level of

37 ibid, pp.65-70.
uncertainty associated with the decisions, which are made on the basis of financial statements and reports.

CORPORATE DISCLOSURE AND TRANSPARENCY

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situations, performance, ownership and governance of the company.

A company often makes voluntary disclosure that goes beyond minimum disclosure requirements in response to market demand. A strong disclosure regime can help to attract capital and maintain confidence in the capital market. Shareholders and potential investors require access to regular, reliable and comparable information, in sufficient detail for them to assess the stewardship of management and make informed decisions about the valuation, ownership and voting of shares.

Disclosure requirements are not expected to place unreasonable administrative or cost burden on enterprises. The principles support timely disclosure of all material developments that arise between regular reports. They also support simultaneous reporting of information to all the shareholders in order to ensure their equitable treatment.

The following are, few qualities required for high transparency in corporate disclosure:

(A) Disclosure should include, but not be limited to, material information on,

(i) The financial and operating results of the company.
(ii) The objectives of the company.

(iii) The major share ownership and voting rights.

(iv) Members of the board and key executives and their remuneration.

(v) Foreseeable risk factors.

(vi) Employees and other stakeholders.

(vii) Governance structure and policies.

(B) Information should be prepared, audited and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure and audit.

(C) An independent auditor should conduct annual audit in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

(D) Channels for disseminating information should provide for fair, timely and cost efficient access to relevant information by users.40

PRESENTATION OF CORPORATE FINANCIAL REPORTING

There cannot be a single method of presentation of information to make it an adequate disclosure. In order to make a disclosure an adequate one, following precaution may be taken: -

i) EASY TO UNDERSTAND

The information should be presented in such a manner that a person of average knowledge and prudence could easily understand it. One should derive the same meaning from the information as it is proposed to convey.

ii) AVOID MIS-INTERPRETATION

Form of presentation should be designed as to minimize the possibility of mis-interpretation.

III) SYSTEMATIC MANNER

All information disclosed in financial statements must be organized in some logical manner.

iv) FINANCIAL STATEMENTS

The disclosure should be made in the body of formal financial statements to the extent it is practical.

v) FLEXIBLE

If financial statements are unable to absorb essential information, they can be modified to include more data by supporting schedules and notes annexed to financial statements.

vi) SOPHISTICATED METHODS

In order to make the disclosure adequate, more modern and sophisticated, methods of disclosure such as, value added statements, cash flow statements, human resources accounting, etc, could also be used in financial reporting.
vii) APPROPRIATE PLACE

All significant information should be presented at a place in the annual report, which may not be overlooked easily.

QUALITY OF CFR

The purpose of CFR will be successful, only when the CFR has prescribed standards and qualities. The CFR should have qualities like, full disclosure, decision usefulness, materiality, consistency, reliability, neutrality, verifiability, comparability, understandability, fairness, completeness, timeliness and conservation. The purpose of CFR is judged by the users with the help of these types of qualities and standards.

REPORTING FORECASTS

The financial report should consist of data and information that is useful not only to judge the past performance of the enterprise but should also enable the users to predict and evaluate the efficiency and profitability of the enterprise.

A well-prepared reasonable forecast is an important piece of information about the company’s future performance. It would enable the existing and prospective investors to look into the future performance of the company. Very often, it is the expected performance in the next year that many an investor would like to know.

The disclosure of business forecasts, besides income statement, balance sheet, fund flow statement and the associated details would greatly improve the utility of a company’s financial report. The practice of reporting forecasts for external purpose will also serve the function of public relations. A study conducted by Prof.
Shankaraiah and Sudarshan\textsuperscript{41} in Andhra Pradesh revealed that none of the enterprise covered by the study disclosed the forthcoming year's forecasts. Jawahar Lal\textsuperscript{42} reported that none of the 180 companies covered by his study disclosed the forecasts of the up-coming year’s earnings per share.

The presentation may be made more meaningful by introducing a three columnar style, which may exhibit the actual, estimates and the variance for the year under review, besides the actual for the previous year and the forecasts for the next year. If the actual of ten years immediate past are also presented, it will be highly informative and would give a good picture of the company’s position.

The forecasts for the purpose of disclosure should be reasonable. They should be the realistic estimates of the future performance.

ADVANTAGES OF ADEQUATE DISCLOSURE

The adequate disclosure in financial statement and reports has the following advantages:

1. ECONOMIC DECISIONS

On the basis of the reported information the investors can assess the risk attached, return on investment, etc, and thus it helps to make sound economic decisions.


2. PUBLIC CONFIDENCE

By adequate disclosure of financial information in financial statements and reports, public confidence can be won and thereby, the capital procurement is facilitated.

3. EASY BORROWING

By creating the favorable impact of financial activities through financial statements, the value of shares will go up and as a result, the demand for the shares of the company will be high. This will reduce the borrowings of the company, reducing the cost of capital.

4. STABILIZING SHARE PRICE

Adequate disclosure of financial information will minimize the fluctuations in the value of shares reducing the degree of uncertainty prevailing in the investment market.

5. EMPLOYEES BENEFIT

The reported financial information will help the employees to assess the risk and growth potential of the company, their job security and possibilities of promotions in future.

6. LABOUR UNIONS

Adequate disclosure of financial information will provide labour unions, a basis for making contractual wages and employment benefit demands.
7. LONG-TERM SOLVENCY

The outside parties such as financial institutions, suppliers and creditors, etc., who are interested in the long-term solvency of the company will be aided in making their economic decisions about the undertaking.

8. COMPARATIVE STUDY

A consistent disclosure of financial information will help the management to make a comparative study with the previous periods or years of the company's financial position and its earning capacity.

9. EFFICIENCY

This also helps in judging the managerial ability to utilize enterprise's resources efficiently in achieving the primary goal of the company, i.e., the profit and wealth maximization.

DISADVANTAGES OF ADEQUATE DISCLOSURE

1. COMPETITORS

It is felt that adequate disclosure of financial information in vital strategies formulation will help the competitors of the company.

2. MANAGEMENT

The management usually feels that the need for further disclosure is very little apart from the statutory regulations regarding the contents of the published accounts.
3. FAULTY INTERPRETATION

Sometimes faulty interpretation will be drawn on the basis of reported information by investors, if they are not properly understood by them and it will mislead them in their investment decisions.

4. EMPLOYEES

Mostly, the management hesitates to disclose the entire financial information regarding the activities of the undertaking because of the fear of unfavorable reactions of the employees on the shortcoming of the management.

5. SHARE PRICE FLUCTUATIONS

Since the negative response will increase the degree of fluctuations in the value of shares, the management, beyond the statutory requirements, avoids the disclosure of financial information.

6. COSTLY

The collection of additional information and its publication in the annual report is too costly.

7. INFORMATIONAL NEEDS OF USERS

A lack of knowledge of the informational needs of investors is also given as a reason for inadequate disclosure.

SCOPE FOR MANIPULATION

The purposes of corporate reporting are to provide a true and fair view of a company’s affairs to the users of the annual report. Despite various statutory regulations and well-developed accounting standards, a number of companies do tend
to make adjustments in the annual report without adequate disclosure. The areas where such practices are prevalent are:

a) DEPRECIATION

Either by change of method of depreciation from written down value (WDV) to straight line method or vice versa, and changing the rate of depreciation or life of the asset with a view to improve the profit position.

b) RESEARCH AND DEVELOPMENT EXPENDITURE

Due to difficulty in differentiating the research and development expenditure between pure research and developmental research, there is scope for treating such expenditure in more than one way in each year.

c) CAPITALISATION OF LEASE EXPENDITURE

Depending on whether an asset is leased on financial or operating lease basis, such financial arrangement may be shown in such a way that it reflects on the performance of the company fully. The details of lease should be disclosed.

d) CAPITALISATION OF INTEREST

There are companies, which despite standard accounting practices being made available, continue to capitalize interest even after commercial commissioning.

e) AMORTISATION OF PRELIMINARY EXPENSES

In absence of any hard and fast rule for the above type of expenses, the policy for such expenses can be changed depending on the need for showing improved profit performance.
f) INVENTORY VALUATION PRACTICES

This is yet another major area, where policy changes are made by companies without disclosure. Often, the basis of valuation – LIFO or FIFO is changed from one to the other without adequate disclosure.

g) RETIREMENT GRATUITY

A change from ‘accrual’ to ‘cash’ basis of accounting avoids provision for gratuity or can be written back in improving the profit performance.

h) EXCHANGE RATE FLUCTUATIONS

A change in the date of exchange rate without disclosure, results in misleading profit reporting.

i) REVALUATION OF ASSETS

Many companies revalue their assets to improve their capital structure. While revaluation is disclosed, the depreciation provision may or mayn’t be charged accordingly.

RECENT TRENDS

It has been observed that accounting information is delineated in different forms for different purposes. Its importance has been growing very rapidly at home as well as abroad, due to the following reasons:

1. New dimensions in the concept of corporate reporting.

2. Changes in the pattern of share ownership. It is widely dispersed now.

3. Inviting foreign collaboration by the public limited companies. This is a recent phenomenon in Indian industry.
4. Seeking financial assistance from the international financial institutions, i.e., IBRD, IDA, ADB, etc.

5. Getting financial assistance from the National and State financial institutions. Besides these, commercial banks have also become the main source of permanent capital.

6. The governments' emphasis on participation of workers in management. A national seminar was held at New Delhi in which the Prime Minister has laid stress on this issue. The Transpack Industries Ltd, Baroda is becoming the first corporate unit in Indian corporate business by allotting 11 per cent equity shares ownership to its employees.

7. The corporate sector is becoming the main source of revenue to the Central as well as State governments.

8. Corporate reports are becoming an instrument to communicate the accounting and non-accounting information to their users.

9. Large scale units are required to take finance directly from the capital market rather than from financial institutions. They have to convince mass investors regarding their financial needs and credit worthiness.

10. New developments in the information technology sector demands for a changed disclosure mechanism.

11. Liberalisation of Indian economy and the concept of common market.


13. The gradual adoption of automation in accounting area has struck the very basis of traditional reporting system.

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43 The Times of India, January 14, 1990.

STUDIES ON CORPORATE REPORTING

STUDIES CONDUCTED ABROAD

A survey of the literature on corporate disclosure reveals that most of the empirical studies on the subject have been conducted in foreign countries such as, USA, UK, New Zealand and Mexico.

The pioneer study on measuring corporate disclosure through index of disclosure has been perhaps, conducted by Cerf (1961). He scanned the annual reports of 527 companies by applying the index of disclosure consisting of 31 items. He used the weighted index of disclosure for computing the disclosure score in the annual reports of all the 527 companies. He examined the extent to which the company characteristics had an effect on the disclosure score.

He concluded from his study that a positive relationship existed between the disclosure score and the company characteristics. The study conducted by Cerf being the first of its kind, is very significant in the literature on corporate disclosure. However, one of the major limitations of his study is the number of items included in the index of disclosure.

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Singhvi\textsuperscript{45} (1967) compared corporate disclosure in annual reports in India with the United States. Using an index of disclosure consisting of 34 items, he found that quality of disclosure in India was not as good as that in the USA.

\textbf{Copeland and Frederick}\textsuperscript{46} (1968) measured the relationship between materiality of items and extent of the disclosure. The annual reports of the companies included in the listing applications [NYSE] were scanned by them to know as to whether these items of information were disclosed there. They applied spearman’s rank correlation test to know whether significant differences existed in the ranking of reasons by materiality and by disclosure. The test results indicated that there was a positive relation between materiality and disclosure, i.e., more material factors are disclosed more fully. However, the co-efficient of correlation was insignificant at 5 per cent level of confidence.

Copeland and Fredericks have admitted in their study that the ‘conclusion drawn can at least, be tentative. Replication of the study and application of other techniques are needed to provide new evidence to support or reject our findings’.

In ‘perception of financial reporting practices: An empirical study’, Carpenter, Francia and Strawser\textsuperscript{47} (1971), examined the preparers’, attesters’ and users’ perceptions of current problem areas in financial reporting. They prepared a questionnaire and the respondents were asked to encircle a number from 1 to 7 on a

rating scale. Though this study highlighted certain important deficient areas of financial reporting, it suffers from the major limitation that the authors did not carry out the cross-sectional analysis of the responses of preparers' attesters' and user's. Obviously, if this had been done, the differences in the perceptions of 'different interested groups' would have been made known.

Singhvi and Desai⁴⁸ (1971) in "An empirical analysis of the quality of corporate financial disclosure" studied the association between company characteristics and the disclosure of information. They also analysed as to whether disclosure had any impact on the market value of securities. Their study is based on the annual reports of 100 listed companies for the year 1965-66. They basically adopted the 'index of disclosure' used by Cerf (1961) in his study. They concluded that there was a positive relationship between selected company characteristics and disclosure. They also proved that inadequate corporate disclosure in annual reports is likely to widen fluctuations in the market price of a security.

Gyan Chandra⁴⁹ (1974) made an attempt to examine whether those who attest the corporate reports and those who use such reports, i.e., the public accountants and the security analysts respectively, have any consensus about the value of information included in the published corporate annual reports. The overall result of this study was that there was a lack of consensus between the accountants and the security analysts regarding the value of information disclosed in an annual report.

⁴⁹ ibid, pp.733-742.
In a study on 'selected items of information and their disclosure in annual report', Buzby\(^5\) (1974) analysed the disclosure practices of selected items in the annual reports of 88 small and medium size companies. The results indicated that many of the items of information were inadequately disclosed by the sample companies and the correlation between the relative importance of the items and their extent of disclosure was small.

Stanga\(^5\) (1974) analysed the current financial reporting practices of large industrial companies and made an attempt to measure the influence of two variables (i.e., size of the company and the industry), on the disclosure practices of large industrial companies. The size of the company and nature of industry had a positive relationship with disclosure score.

Firth\(^5\) (1979) studied the impact of size, stock market listing and auditors, on voluntary disclosure in corporate annual reports. He included 48 items of information in his index. None of the 48 items were required by law to be disclosed in the annual report. He concluded that both, size of the company as measured by sales turnover and capital employed and stock market listing were related to disclosure, but the auditor factor had no impact on disclosure.

McNally, Hock Eng and Hasseldine\(^5\) (1982) analysed the financial reporting practices of 103 manufacturing companies listed on the New Zealand stock


\(^5\) ibid,pp.11-20.
The study revealed that the level of actual disclosure by companies was lower than what the professional external users perceived to be desirable and there was a considerable variation across the 41 items in the degree of non-disclosure. They concluded that a positive relationship existed between size and both, the number of items disclosed and the average score for each company. None of the other three characteristics, viz., rate of return, growth and auditors were significantly related to the measures of actual company disclosure.

A study on 'Voluntary financial disclosure by Mexican corporations' has been conducted by Chow and Wong-Boren\(^54\) (1987) to know the voluntary financial disclosure practices of 52 listed Mexican corporations and to find out whether the extent of disclosure was related to the selected company characteristics. They constructed an index of disclosure consisting of 24 items for this purpose. Two disclosure scores for each sample firm were calculated. One was the weighted score and the other was an unweighted score. The study concluded that the correlation between unweighted score and weighted score was significant. Neither of the selected characteristics of the companies was significantly related to the measures of actual company disclosure.

**STUDIES CONDUCTED IN INDIA**

Tilak Shankar\(^55\) (1972) conducted a study to examine the adequacy of corporate reporting in the Indian annual reports, as compared to the annual reports of foreign countries (USA). He selected 50 Indian and 25 foreign annual reports for the


purpose of this study. On the basis of this study, he concluded that, 'the Indian companies balance sheet is the least innovative and informative and is prepared largely within the legal framework'. The Indian annual reports were lagging behind their foreign counterparts with respect to the disclosure of many items. The study suggests that the joint efforts on the part of the shareholders acting as watch dogs, accounting profession-suggesting the ways to improve disclosure and the companies-innovating into the new area of corporate reporting, can improve the disclosure in the Indian annual reports.

N. Das Gupta\(^5\) (1977), in a study on, 'financial reporting in India', has critically analysed the financial reporting practices prevalent in India. The author has also reviewed the financial reporting requirements in foreign countries, such as, USA, Australia, UK, France, Japan, and etc. The author has laid greater emphasis on the review of the legal framework on disclosure in India and other countries, exposure drafts and statements issued by professional accounting bodies in U.K and USA and the accounting standards issued by the 'International Accounting Standard Committee' (IASC).

Singh and Gupta\(^6\) (1977), in their study on 'corporate financial disclosure in Indian companies' examined the relationship between seven organizational correlates and the quality of disclosure. The authors prepared an index of disclosure consisting of 32 important items. On the basis of the findings of their

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study, Singh and Gupta concluded that the public sector companies were disclosing more information than the private sector companies.

**Singh and Bhargava**\(^{58}\) (1978) examined the disclosure of financial and non-financial information in the annual reports of 40 public sector enterprises, on the basis of index of disclosure consisting of 35 items. The findings of the study indicated that there were differences in the quality of disclosure of information in the sample companies.

**Seshan and Gujrathi**\(^{59}\) (1980) carried out a survey of the financial reporting practices followed by 200 public limited companies in India. They laid emphasis on studying the form and contents of the balance sheet, profit and loss account, auditor’s report and director’s report of the sample companies, and the disclosure of information such as, accounting policies, inflation adjusted statement, consolidated financial statements, historical summaries and highlights of the year’s operations. The authors concluded that many companies did not report the accounting policies and the supplementary financial statements in their annual reports and laid emphasis on the inclusion of these statements in the annual reports.

**Jawahar Lal**\(^{60}\) (1985) examined the disclosure practices of 180 manufacturing companies in the private sector. The study remained confined to the years 1965 and 1975. The author also made an attempt to examine the impact of four

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company characteristics, on the quality of disclosure. In all 50 items of information were examined for measuring the extent of disclosure in the annual reports of the selected companies. The study concluded that the disclosure of the selected items of information in the annual reports improved in 1975 over 1965.

The regression results revealed positive association between size of the company, earning margin, nature of industry and the association with a large industrial house and the extent of disclosure.

The Research Committee of the Institute of Chartered Accountants of India⁶¹ (1985) surveyed the published accounts of 87 private sector companies and 25 public sector companies, to highlight the financial reporting practices being followed by them. The study concluded that the companies in the public sector provided much more information than those in the private sector.

Geeta Garg⁶² (1986) analysed the disclosure practices of 51 of the largest manufacturing companies in the private sector, by constructing an index of disclosure consisting of statutory as well as non-statutory (voluntary) information. She concluded that almost in all the countries, the companies’ disclosed the information, which is compulsorily required by law.

⁶¹ Institute of Chartered Accountants of India, “Trends in Published Accounts”, New Delhi, 1985, p.106.
Subhash Chander⁶³ (1992), examined the published accounts of 47 public sector companies and 50 private sector companies for a period of five years, i.e., from 1980-81 to 1984-85, to highlight the financial reporting practices being followed by them. The author also made an attempt to examine the impact of four selected company characteristics, viz., size of a company, age of a company, earning margin and nature of industry, on the quality of disclosure.

The study concluded that the companies in the public sector provided much more information than those in the private sector. The regression results revealed positive associations between the size of the company, earning margin, age of the company and nature of industry and the extent of disclosure.

The foregoing review of the empirical studies, conducted on corporate disclosure, reveals that no comprehensive study seems to have been conducted in India to examine the disclosure practices of corporate sector and the significance of different items of disclosure as perceived by various users of the corporate annual reports. Moreover, the conclusions drawn by these studies do not remain highly relevant now a days, when the subject of ‘corporate disclosure ‘ has caught much attention of the corporate sector, professional bodies and the users of the annual reports.

CONCLUSION

In view of the above, an attempt has been made to study corporate disclosure practices in the late nineties. The study aims at providing up to date information regarding corporate practices in India for the period of study. The study also attempts to examine the significance of different items of disclosure as perceived by various users of the corporate annual reports. This study is conducted in the light of the Companies Act, new amendments on corporate disclosure practices, SEBI Act, which was enacted in 1992, and the SEBI guidelines in 1994.

For the first time in India, an attempt has been made to know whether there is any consensus between the significance of various items, as attached by various users of the annual report, their corresponding disclosure in the annual reports and the management preference regarding disclosure.

As revealed by a survey of the literature, so far no concrete study has been conducted in this area in the late '90s. In view of the above, the present study assumes importance as it focuses on the recent developments.