REGULATORY FRAMEWORK OF THE INDIAN AND THE US CORPORATE DISCLOSURE PRACTICES
CHAPTER III

REGULATORY FRAMEWORK OF THE INDIAN AND THE US CORPORATE DISCLOSURE PRACTICES

The previous chapter focussed on the major issues regarding the corporate disclosure practices, viz., for whom should the information be disclosed, what should be the objectives of disclosing such information, when should the information be disclosed and how much information should be disclosed. This chapter discusses another significant issue relating to the corporate disclosure, i.e., need for regulation of corporate disclosure practices. The chapter also discusses the regulatory framework governing the corporate disclosure practices in India and the US. An attempt has also been made to comprehend some of the major differences in the Indian and the US GAAPs affecting the corporate disclosure practices.

3.1 NEED FOR THE REGULATION OF CORPORATE DISCLOSURE PRACTICES

Should companies be mandatorily required by law to disclose a certain minimum level of information or will the imperatives of market force them to make such disclosures? This is a debatable matter.

The proponents of "free market approach" suggest that disclosure adequacy is best advanced by allowing enterprises to decide on the appropriate level of disclosure according to their particular circumstances [Foster (1980)]. Corporate managers have various incentives to disclose...
more information, as their firms compete to reduce the costs of obtaining funds from the market. Many research studies have shown that the level of voluntary disclosure of companies increases as they enter competitive financial markets (Choi 1973, Meek and Gray (1989). The Special Committee on Financial Reporting of the American Institute of Certified Public Accountants (1994) also known as Jenkins Committee states that an important benefit of greater disclosure is the lower cost of equity capital. The study conducted by Botosan (1997) also provides direct evidence of an association between cost of equity Capital and disclosure level. The companies also have the incentives to disclose greater amount of information in order to enhance their corporate image and to reduce their political costs. This option indicates that securities regulators and government economic planners should focus their efforts on encouraging more companies to list in domestic stock exchanges, perhaps using tax and other fiscal incentives, rather than in imposing numerous and costly disclosure standards [Saudagaran (1997)].

The above benefits or incentives of voluntary corporate disclosure, however come appended with some costs or disincentives which hold back the companies from disclosing more information. Corporate managers are reluctant to disclose more information because of the fear of perceived misuse of information and the costs of competitive disadvantage. Managers will disclose only that information which suits them; they may suppress information if it does not suit them even if such information is useful to the users of the financial statements. The advocates of "mandatory regulatory approach" argue that an adequate framework of
disclosure regulation is necessary because of the potential for market failure in the absence of financial information [Bromwich (1985)]. Where financial information possesses the characteristics of a public good, a strong probability exists that information will be under-produced in the absence of mandatory regulations [Saudagar (1997)]. Without adequate information, investors will be reluctant to participate in the markets that are perceived to be rigged in favour of certain vested interests.

It is therefore evident that the companies cannot be relied upon to make a full and fair disclosure of information on their own. There must be some regulation to prescribe certain minimum level of information to be disclosed by all the companies. However, the business managers have unfettered freedom to decide what information is to be disclosed voluntarily - except for information that could be potentially misleading [Venkatesh (1997)].

Solomon (1986) a strong proponent of regulation has given the following additional arguments for regulation of corporate disclosures.

1. Regulation facilitates comparisons across companies.
2. Regulation is necessary, given the limited capacity of users to interpret and use information. Standardisation of formats and terminology leave the user free from the burden of trying to interpret the forms and the terms.
3. Regulation can improve the credibility of information in the eyes of the users.
Beaver (1989) has given following arguments of such regulation:

1. Financial reporting involves externalities. An externality exists when the actions of one party have effects on other parties who are not charged via the price mechanism. For example, externalities could occur when information about the productive opportunities of one firm conveys information about the productive opportunities of other firms. Shareholders in the disclosing firm pay the costs of disclosure, but the shareholders in other firms do not, even though they are affected by the disclosure.

2. Left unregulated, market forces would lead to an assymetrical or uneven possession of information among investors.

3. Corporate managers have incentives to suppress unfavourable information.

In practice, these arguments for regulation of corporate disclosures have proved to be quite persuasive. All countries have a regulatory framework for financial reporting and disclosure.

3.2 MODES OF REGULATION OF CORPORATE DISCLOSURE

Corporate disclosure can be regulated in several ways. Puxy et.al. (1987) visualise a continuum of regulatory modes which has 'liberalism' and 'legalism' as its two extremes. Associationism' and 'Corporatism' lie in between the two. In 'liberalism', regulation is provided exclusively by the discipline of the market and in legalism, accounting practices follow the letter of law. Further, associationism refers to the accomplishment of
regulation through the development of organisations that are formed to represent and advance the interests of their members. In 'Corporatism' the Government licences organised interest groups to regulate disclosure as well as incorporates them into its own centralised system of regulation.

Puxty et.al. suggest that the USA follows both the legalist and the associationist mode of regulation with the latter subordinated to the former. Applying the Puxty et.al. framework to India, it appears that the country is closer to the associationist system than to other systems [Narayanaswamy (1997)].

### 3.3 REGULATION OF CORPORATE DISCLOSURE IN INDIA

In India, corporate disclosure is governed by the Companies Act, 1956, pronouncements of the Institute of Chartered Accountants of India (ICAI), guidelines of the Securities and Exchange Board of India (SEBI) and the circulars issued from time to time by the Department of Company Affairs.

#### 3.3.1 THE COMPANIES ACT, 1956

The form and contents of annual reports in India have undergone significant changes in response to the legal requirements in this regard. Legal requirements have witnessed vital changes over a period of time owing to the demands of time.

The first statutory act giving a legal recognition to the preparation of balance sheet was the Indian Companies Act 1882. This Act was Modelled on the lines of the British companies
3.3.1 THE COMPANIES ACT, 1956

The form and contents of annual reports in India have undergone significant changes in response to the legal requirements in this regard. Legal requirements have witnessed vital changes over a period owing to the demands of time.

The first statutory act giving a legal recognition to the preparation of balance sheet was the Indian Companies Act, 1882. This Act was modelled on the lines of the British Companies Act because of the influence of the British colonisation on the country. Section 74 of the Act made the preparation and audit of balance sheet compulsory, while the preparation of profit and loss account and laying and circulation of annual accounts, contents of auditor's report and directors' report were contained in the optional regulations 78 to 94 of the Act. However, the information required to be disclosed was very limited.

The Companies Act of 1913 contained more detailed provisions regarding published accounts. Section 130 to 132 dealt with these provisions. Articles 107 to 108 of Table A presented guidelines for the preparation of profit & loss and balance sheet. Form F of Schedule III gave a compulsory form of balance sheet.

Companies (Amendment) Act 1936 introduced significant changes. Profit and loss account was given a status equal to that of a balance sheet. Section 131 made the directors' report on accounts compulsory. Section 132(3) required disclosure in profit and loss account of certain information of importance to the shareholders regarding remuneration to agents,
directors and managers. Section 132-A, a new section, made information on subsidiary companies compulsory.

The report of the Company Law Committee known as Bhabha Committee released in 1952 was a major break though in the history of the regulation of corporate disclosure in India.

The committee found that most of the directors' reports were colourless documents which did little to inform or educate the shareholders. It observed that the form of balance sheet and contents of profit and loss account should be such as good make available to the shareholders as much information relating to the affairs of a company as it is possible to disclose without giving any information which could be detrimental to the interests of the company.

On the basis of the above recommendations the Companies Act, 1956 was passed. The Act greatly enlarged the scope of corporate disclosure Sections 210, 211, 212, 216, 217, 227 (1A), 227 (2), 227 (3), 227 (4A), 619 and 641 of the Act contain various provisions relating to the corporate disclosure. Section 211 of the Act required the preparation of balance sheet and profit and loss account in the form set out in Part I and Part II of Schedule VI of the Act. Section 212 specifies certain particulars to be included in the balance sheet of holding company with regard to its subsidiaries Section 217 requires the preparations of report by the Board of Directors of the company to be attached with the balance sheet. The section also specifies particulars to be included in the Board's Report. Sections 227(1A), 227 (2), 227 (3), 227 (4A) deal with the matters to be included in the auditor’s report. Section 619 deals with the annual reports.
of the government companies. Section 641 deals with the power of central Government to alter schedules by notification in the Official Gazzette.

Since the passing of Companies Act, 1956, a number of amendments have been made in the Act from time to time requiring the disclosure of additional information in annual reports. The amendment made in 1961 required the disclosure of certain additional information in the profit and loss account, while some unnecessary items in the balance sheet were removed.

The amendment made in 1973 required the disclosure of additional information in financial statements, viz., details regarding licensed capacity, installed capacity and actual production in respect of each class of goods, details regarding raw materials consumed or purchased, quantities and amounts in respect of each class of goods.

The Companies (Amendment) Act of 1974 inserted section 217(2A), which made it obligatory for the companies to include in the report of Board of Directors, the names of employees getting remuneration not less than the amount which may be prescribed, their relationship, if any, with any of the directors of the company.

Another significant amendment affecting the corporate disclosure was made in the year 1988 in section 219 of the Companies Act. The amendment gave a choice to the listed companies either to send detailed accounts to their shareholders or statement containing only the salient features (abridged annual report). The Amendment Act of 1988 also required inclusion of particulars relating to the conservation of energy and technology absorption in the Board's report.
The Companies Bill of 1993 proposed many changes in disclosure requirements. But the bill was withdrawn by the parliament and the changes could not be implemented.

Schedule VI to the Companies Act, 1956 was amended by Notification GNR 388(E) dated 15-5-95, whereby Part IV dealing with 'Balance Sheet, Abstract and Company's General Business Profile' has been inserted [Wadhwa (1997)]. This amendment will have effect in relation to financial year closing after 15-5-95. The information required in Part IV includes registration details; capital raised during the year through public issue, bonus issue, right issue, private placement; position of mobilisation and employment of funds; performance of the company as represented by its turnover, total expenditure, profit or loss, earnings per share, dividend; generic names of three principal products or services of company.

In exercise of the powers conferred by sub-section (i) of section 641 of the Companies Act, 1956, the Central Government made further alterations in Schedule IV to the Act on 13-9-96. It required that all unutilized monies out of the issue must be separately disclosed in the balance sheet of the company indicating the form in which such unutilized funds have been invested.

In the year 1996, a working group was set up to prepare a new draft of the law on companies and make it available for public debate. The main objective of re-enacting the Companies Act is to facilitate a healthy growth of the Indian corporate sector under a liberalised, fast changing and competitive environment. The recommendations contained in the
report of the working group formed the basis of the Companies Bill, 1997. The Bill seeks to repeal and re-enact the Companies Act of 1956. The Bill proposes to reduce the size of the present Companies Act, 1956 from 658 sections and 15 schedules to 458 sections and 3 schedules. The salient features of the Bill affecting corporate disclosure are as follows:

(i) Classification of Companies

The Bill provides for three-fold classification of companies, that is-
(a) private companies, which are proposed to be largely self-governing but prohibited from inviting and accepting deposits from the public and not be deemed as companies; (b) unlisted public companies, which will be subject to minimum government regulations; (c) listed public companies, which will be subject to greater regulation including stricter disclosure norms.

(ii) Director's Responsibility Statement

As per the Companies Bill of 1997, the Board's report shall also include a director's responsibility statement indicating there in- a) that in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures; (b) that the directors had selected such accounting policies and applied them consistently and made judgements and estimates that are reasonable and prudent so as to give a true and a fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period; c) that the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act.
for safeguarding the assets of the company and for preventing and
detecting fraud and other irregularities, and that the directors had
prepared the annual accounts on a going concern basis.

iii) Segment Information

The Bill requires that the Board's report of every listed company
shall include information with respect to the following particulars in
relation to each of its divisions and business segments of which the share
is ten percent or more of the total turnover of the company - a) review of
operations during the financial year of the company to which the balance
sheet relates and on the date of the report; b) market conditions during
the financial year of the company to which the balance sheet relates and
on the date of the report; c) and future prospects.

(iv) Statement on Significant Accounting Policies

A Statement on significant accounting policies adopted in the
preparation of the balance sheet and the profit and loss account shall be
disclosed in the company's balance sheet and where any of the accounting
policies is not in conformity with accounting standards, and the
particulars of departure from the accounting standards is material, the
said particulars of departure shall be disclosed together with the reasons
thereof and the financial effect thereof.

(v) Group Accounts

The Bill of 1997 gives an option to the holding company to prepare
group accounts, that is to say, the balance sheet, profit and loss account
and other related statements for itself and its subsidiary or subsidiaries.
The Bill also confers power upon the Central Government to make
mandatory the preparation of such group accounts from a future date to be notified.

vi) Information Regarding Derivatives, Options and Shares with Different Voting Rights

The annual accounts of the company shall state the derivatives, options and shares with different voting rights in the balance sheet. They shall be categorised as quasi-equity and disclose the predominant character of the security and voting rights embedded in the security.

(vii) The Bill proposes to do away with the provisions relating to abridged annual reports.

(viii) In case the company has bought back any shares during the year, the number and nominal value of such shares and important terms on which such shares have been bought back shall be shown by way of footnote to the balance sheet.

(ix) Terms of conversion of any depository receipt should be stated together with earliest date of conversion or redemption in the balance sheet, shares issuable under conversion option should be specified.

3.3.2 The Institute of Chartered Accountants of India

It is a premier professional accountancy body in India. It plays a significant role in regulating the corporate disclosure practices in India. The Institute is one of the members of the International Accounting Standards Committee (IASC) and has agreed to support the objectives of IASC. It issues Statements, Guidance Notes, and Accounting Standards containing various rules of accounting measurements and disclosure.
The Institute also holds competition for the best published accounts annually and thus motivates the companies to make their annual reports comprehensive, informative and useful to investors and other users. Thus the ICAI plays a pivotal role so far as the disclosure practices of the Indian companies are concerned.

3.3.3 The Securities and Exchange Board of India

The Government of India has established the Securities and Exchange Board of India (SEBI) on the lines of the SEC of the USA with the main objective of promoting the securities market and protecting the interests of investors. It is one of the specific objectives of the SEBI to protect the rights of investors through adequate accurate and authentic information disclosure on a continuous basis.

Since 1992, the SEBI has restricted its role in financial disclosure to improving disclosure in prospectus and other offer documents and has stayed away from financial reports. Of late, it seems to be getting more active in the financial reporting arena. For example, in May 1995, it directed stock exchanges to amend the listing agreement so as to require listed companies to publish cash flow statements and to send their shareholders full annual reports rather than abridged ones currently permitted by the Companies Act.

3.4 REGULATION OF CORPORATE DISCLOSURE PRACTICES IN THE USA

Corporate disclosure practices in the USA are governed by the Securities Acts of 1933 and 1934, The Securities and Exchange

3.4.1 THE SECURITIES ACT

Federal legislation was first enacted in 1933 with the passage of the Securities Act. The Securities Act of 1933 is characterised as a disclosure statute [Benston (1978)]. It sought to protect investors by requiring that prospectuses be filed which included specified financial data audited by independent public accountants. The Securities Exchange Act, 1934 required periodic financial statements disclosure of corporations for the first time.

The Securities Acts of 1933 and 1934 were modelled on the lines of the UK Companies Act but these are more extensive and go beyond the provisions of the UK Companies Act in many cases.

3.4.2 THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission (SEC), which administers the Securities Acts of 1933 and 1934 is an independent agency functioning as a quasi-judicial, quasi-legislative and administrative body [Benston (1978)]. It is the mouth-piece of the Federal Government. The Securities Acts give the SEC the power to prescribe "....................the items or details to be shown in the balance sheet and the earnings statement, and the methods to be followed in the preparation of reports, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and non-recurring income, in the differentiation of investment and operating income and in the preparation, where the commission deems it necessary or desirable, of
Under SEC rules, every such corporation to whom such rules apply, is required on registration and annually thereafter, to file financial statements for the parent company and all majority owned subsidiaries on the consolidated and/or individual basis. The SEC prepares forms that list the specific items that registrants must disclose.

The SEC had played an active role in the development of disclosure principles including issuing its own pronouncements. The SEC has the statutory authority to establish such GAAP of publicly held entities, but has relied on the accounting profession for self-regulation.

3.4.4. THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS.

The American Institute of Certified Public Accountants (AICPA) is the professional body of accountants of the USA. It has played a significant role in the development of corporate disclosure practices in the USA. The creation of the SEC in 1934 gave a considerable spur to the AICPA although the Institute's concern predated the passage of the Securities Acts. The AICPA was given considerable derivative de facto power over accounting and auditing procedures. Rather than developing its rules by itself, the SEC relied heavily on the AICPA's rules and pronouncements.

Over the years, the AICPA has adopted a fairly long series of rules and pronouncements. In the year 1930, it created a Committee on Accounting Procedures to co-operate with the New York Stock Exchange in creating standards for accounting procedure. This committee published
51 Accounting Research Bulletins (ARBs). The Committee was also instrumental in attempting to make accounting terminology uniform. However, the Committee's method of operation came into question in the late 1950s as the need for research into accounting principles became obvious. The result was the substitution of the Accounting Principles Board (APB) for the Committee in order to promulgate principles based primarily on the research of the Accounting Research Division. During the 14 years of the Board, 31 opinions and 4 statements were issued. These dealt with amendments of ARBs opinions on the form and content of financial statements and issuances requiring changes both the measurement and disclosure policies of the profession. But, as a result of certain operational problems and the conclusions of the Wheat Study Group, APB was replaced by the Financial Accounting Standards Board (FASB) in 1973. FASB is an autonomous body which is independent of the AICPA. It is worth mentioning that some of the statements and opinions issued by the APB are still operative.

3.4.5 THE FINANCIAL ACCOUNTING STANDARDS BOARD

Since 1973, the FASB has been the designated authoritative organisation that establishes standards of financial accounting [Delaney (1995)]. It is recognised as authoritative through Financial Reporting Release No. 1 of the Securities and Exchange Commission and through Rule 203, Rules of Conduct by the AICPA. The FASB is an independent body relying on the Financial Accounting Foundation for selection of its members and receipt of its budgets.
The Board issues several types of pronouncements. It has issued 117 Statements of Financial Accounting Standards, various Interpretations and Technical Bulletins and 6 Concept Statements [Delaney (1995)]. Statements of Financial Accounting Standards are the most important of these, setting forth mandatory accounting principles. Interpretations are used to classify or elaborate on existing standards or pronouncements of predecessor bodies. Technical bulletins usually address issues not covered directly by existing standards and are primarily used to provide guidance where it is not expected to be costly to create a major change. Statements of Financial Accounting Concepts are designed to constitute a foundation of financial accounting standards, while not recognised as GAAPs themselves.

3.4.6 EMERGING ISSUES TASK FORCE

The Emerging Issues Task Force (EITF) was formed in 1984 by the FASB in order to assist the Board in identifying current or emerging issues and implementation problems that may need to be placed on the agenda of the Board [Delaney (1995)]. Membership on the Task Force consist of persons selected from wide ranging backgrounds who would be aware of issues and practices that should be considered by the group. The FASB publishes a volume of EITF Abstracts which are summaries of each issue paper and the results of Task Force discussion.

3.5. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

Generally accepted accounting principles (GAAPs) are concerned with the measurement of economic activity, the time when such
measurements are made and recorded, the disclosure surrounding these activities and the preparation and presentation of summarized economic activities in financial statements. In APB Statement No. 4, it is stated: "Generally accepted accounting principles encompass the conventions, rules and procedures necessary to define accepted accounting practice at a particular time".

There are two broad categories of accounting principles, viz., measurement and disclosure. Measurement principles determine the timing and basis of Items which enter the accounting cycle and effect the financial statements. Disclosure principles deal with qualitative features that are essential ingredients of a full set of financial statements. Their absence would make the financial statements created by measurement principles misleading by themselves. Disclosure principles complement measurement standards by explaining these standards and giving other information on accounting policies, contingencies, uncertainties, etc. which are essential ingredients in the analytical process of accounting [Delaney (1995)].

3. 5.1 SOURCES OF INDIAN GAAP

The Indian GAAPs consist of a number of pronouncements issued by the ICAI. The ICAI has from time to time issued various Statements, Guidance Notes, and Accounting Standards.

The 'Statements' have been issued with a view to securing compliance by members on matters which in the opinion of the Council are
critical for the proper discharge of their functions, Statements therefore are mandatory.

Guidance Notes are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are recommendatory in nature.

The 'Accounting Standards' issued by the Accounting Standards Board establish standards which have to be complied with to ensure that financial statements are prepared in accordance with the generally accepted accounting practices. They become mandatory on the dates specified either in respective document or by notification issued by the council. Till date, 15 accounting standards have been issued by the ASB of ICAI out of which 13 are mandatory.

There can be situations in which certain matters are covered both by a 'Statement' and by an Accounting Standard. In such a situation, the statement shall prevail till the time the relevant Accounting Standard becomes mandatory. Once an accounting standard becomes mandatory. The concerned 'Statement' or relevant part there of shall automatically stand withdrawn.

3.5.2. SOURCES OF US GAAP

The Auditing Standards Board (ASB) of USA has identified the following as the sources of established US GAAP in the form of a hierarchy [Delaney (1995)]. It is applicable to financial statements of entities other than governmental entities.
a) Category 'A.' officially established accounting principles, consists of FASB Statements of Financial Accounting Standards and Interpretations, APB Opinions and AICPA ARBs (which are in force).

b) Category 'B' consists of FASB Technical Bulletins and if cleared by the FASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.

c) Category 'C' consists of AICPA Accounting Standards Executive Committee (AcSEC) Practice Bulletins that have been cleared by the FASB and consensus positions of the FASB EITF.

d) Category 'D' includes AICPA Accounting Interpretations and Implementation Guides published by the FASB staff and practices that are widely recognised and prevalent either generally or in the industry.

In the absence of any source of established accounting principles, other accounting literature may be considered. These would include APB Statements, AICPA Issue papers, AcSEC Practice Bulletins, FASB Statements of Financial Accounting Concepts, International Accounting Standards Committee Statements of International Accounting Standards, Governmental Accounting Standards Board Statements, Interpretations and Technical Bulletins, Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids, pronouncements of other professional associations or regulatory agencies.
Category A specified above constitutes mandatory GAAP.

Though ASB is not empowered to create GAAPs it has carefully defined such preferability in terms of the audit function in determining fairness in conformity with GAAP which is clearly within its authority.

3.5.3 DISTINGUISHING FEATURES OF THE INDIAN AND THE US GAAPs AFFECTING CORPORATE DISCLOSURE

Significant differences exist in the Indian and the US GAAPs affecting corporate disclosure. This section attempts to comprehend some of these differences.

* Operating and Non Operating Expenses/Income

Operating and non-operating expenses/income should be properly distinguished in the income statement. It is believed by the accountants that the statement users may be misled when operating and non-operating items are not distinguished.

The US GAAP requires a separate disclosure of operating and non-operating expenses/income, whereas the Indian GAAP do not require such distinction.

* Results from Discontinued Operations

Discontinued operations represent separately identifiable segments which are being disposed off. The US GAAPs require a separate disclosure of results from discontinued operations with regard to income (loss) from discontinued operations and gain (loss) on the disposal of discontinued operations. However, Indian GAAPs do not require such disclosures.
*Earnings Per Share*

Earnings per share (EPS) is a very compact indicator of a company's performance. Recognizing its importance, the US GAAP require that the EPS should be disclosed on the face of the income statement. As per APB Opinion Nos.15,20 and 30, EPS information should be disclosed for income from continuing operations, income before extraordinary items and cumulative effect of changes in accounting principles and net income.

The Indian GAAP is silent on this significant issue. However, a recent amendment to schedule VI of Companies Act requires the disclosure of EPS in part IV dealing with 'Balance Sheet Abstract and A Company's General Business Profile.'

*Related Party Transactions*

A related party is a party that controls or can significantly influence the management or operating policies of the company. As per SFAS 57, financial statements should include disclosure of material related party transactions. The disclosures generally should include a) nature of relationship, b) description of transactions and effects of such transactions on the financial statements for each period for which an income statement is presented. c) dollar amount of transactions for each period for which an income statement is presented and effects of any change in establishing the terms of such transactions differently than that used in prior periods and .d) amounts due to and from such related parties as of the date of each balance sheet presented together with the terms and manner of settlement.
The disclosure of above information gives the investors a glimpse of where the company is earning its revenues from and whether the company is deploying its funds mostly in the group activities or in own business. This useful information is a major omission in the Indian GAAP.

* Statement of Cash flows*

The primary purpose of the statement of cash flows is to provide information about the cash receipts and cash payments of an entity during a period. A secondary purpose is to provide information about the investing and financing activities of the entity during the period.

As per US GAAPs, cash inflows and outflows should be classified into three categories, viz., operating, investing and financing. SFAS 95 establishes standards for cash flow reporting by the US companies. SFAS 102 exempts certain enterprises from preparing this statement and provides a classification of cash flows from certain securities. SFAS 104 deals with the classification of cash flows from hedging transactions. SFAS 117 extends the provisions of SFAS 95 to non-profit organisations.

Till recently, Indian GAAP did not require such cash flow statement. In 1997, the ICAI has come up with a revised AS-3 recommending the companies to prepare and present cash flow statement along with their financial statement. It also recommends the classification of cash inflows and outflows into operating, financing and investing activities. However this standard is still recommendatory. Stock exchanges through listed agreements also require the preparation of Cash-Flow Statement for the listed companies.
* Statement of Changes in Stockholders' Equity

Stockholders' equity is comprised of all capital contributed to the entity plus its accumulated earnings less any distributions that have been made. It represents an interest in the net assets of the entity. A major objective of the accounting for stockholders' equity is the adequate disclosure of the sources from which the capital was derived.

The US GAAPs require the preparation of a statement of changes in stockholders' equity which shows the changes taken place in various components of stockholders' equity, viz., preferred stock, common stock, additional paid-in capital, donated capital, retained earnings and treasury stock.

The Indian GAAPs do not require the preparation of such statement.

* Segment Reporting

Segment reporting, i.e., disclosure of information about the operations of an enterprise in different industries, its foreign operations, export sales and its major customers is a relatively recent development in financial reporting. The primary benefit of segment reporting is the release of hidden data from consolidated financial information. Different industry segments and/or geographical areas may possess different levels of profitability, risk and growth. This important information is merged in consolidated amounts.

In the USA, SFAS 14 establishes specific guidelines for the required disclosure of segment information in financial reports issued to stockholders. As per this standard, in case the industry segments and...
foreign operations of an enterprise satisfy the revenues, profitability and identifiable assets tests prescribed by the standard, then the following information must be disclosed for each of them: (i) unaffiliated and intra-enterprise revenue, (ii) operating profit/loss or some similar measure of profitability, (iii) identifiable assets. Similarly, if the amount of export sales to unaffiliated customers is at least 10 percent of consolidated revenue, that amount is to be separately reported in aggregate and by appropriate geographic areas. If an enterprise earns 10 percent or more of its revenue on sale to a single customer, that fact and the amount of revenue from each such customer must be disclosed. The industry segments making these sales must also be disclosed.

While the segment information as required by the US GAAPs is quite telling, the Indian GAAPs is lagging far behind. No accounting standard has been issued on the subject so far. However, as per schedule VI of the Indian Companies Act, 1956, disclosure should be made of the amount and quantities of turnover achieved by each class of goods, the item-wise break up of the value and quantities of raw materials consumed, quantitative information about licensed and installed capacities and actual production by each class of goods and foreign exchange earnings. While this information does provide some insights into the efficiency of operations, it is not as comprehensive as the requirements of the US GAAPs.

* Derivative Financial Instruments (DFIs)

Derivatives are financial instruments that derive their value from changes in a benchmark based on stock prices, interest rates, mortgage
rates, currency rates, commodity prices or some other agreed upon basis. These include option contracts, futures, swaps, forward contracts, forward interest rate agreements, letters of credit etc. The basic purpose of DFIs is to manage some kind of risk, viz., stock price movements, interest rate variations, currency fluctuations and commodity price volatility.

The US GAAPs provide for comprehensive disclosure requirements with regard to these financial instruments. SFAS 105 requires all entities to disclose in the body of financial statements or in footnotes, information about the financial instruments with off-balance sheet risk. Disclosure must include (i) the face, contract or notional principal amount, (ii) the nature and terms of the instruments including a discussion of (a) the credit and market risks (b) the cash requirements and (c) the related accounting policies. SFAS 119 requires that all DFIs should be classified as trading and other than trading. For trading DFIs, the required disclosures also include (a) net gains/losses reported in income by category of financial instrument (b) average fair value of DFIs during the period together with the related value at the end of the period, differentiating assets and liabilities. For other than trading DFIs required disclosures also include (a) description of objectives for holding, context required to understand the objectives and strategy for achieving the objectives (b) a description of how each class of DFI is reported in the statements including recognition and measurement policies and location of DFIs in the balance sheet and where the related gains/losses are reported in income. In case the DFIs are held or issued and accounted for as hedges then (a) the transactions being hedged and about the time
period until occurrence (b) description of the classes of DFls used to hedge (c) amounts of explicitly deferred hedging gains/losses (d) events that result in recognition in earnings of deferred items. SFAS 107 requires entities to disclose the fair value of all financial instruments that it is practicable to estimate. Pertinent descriptive information as to the fair value of the instrument is to be disclosed if an estimate of fair value cannot be made without incurring excessive cost. The amendment of SFAS requires that the fair value information be presented along with the related carrying value.

Indian GAAPs do not prescribe such disclosure requirements, probably because of the low level of development of derivative financial instruments in the country. However, the new Companies Bill of 1997 requires the disclosure of DFls in the Balance-Sheet under the head Quasi-Equity stating the pre-dominant character of the security.

* Consolidated Financial Statements

Consolidated financial statements present, primarily for the benefit of the shareholders and creditors of the parent company, the results of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single enterprise with one or more branches or division.

The US GAAPs require the preparation of consolidated financial statements of the parent company and its subsidiaries by using either pooling or purchase accounting. APB Opinion Nos.16, 17, 18, 29, ARB 51 and SFAS 38, 79, 94 deal with the preparation of consolidated statements. Consolidated statements have to be prepared separately for operations,
balance sheet, statement of cash flows and statement of changes in stockholders' equity.

This useful information is a major omission from the Indian GAAP. However, the Companies Bill of 1997 provides an option to the holding company to prepare group accounts for itself and its subsidiaries. The Bill also confers power upon the Central Government to make mandatory the preparation of such group accounts from a future date to be notified.

* Income Taxes

US GAAPs provide for comprehensive disclosure requirements for income taxes. The primary source of GAAPs relating to income taxes is SFAS 109. A Reporting entity is required to disclose the components of the net deferred tax liability or asset recognized in the statement of financial position as follows:

* Total of all deferred tax liabilities.
* Total of all deferred tax assets.
* Total valuation allowance.
* Net changes in the valuation allowance for the year.
* Types of temporary differences and carry forwards that cause significant portions of deferred tax assets and liabilities.

When deferred tax liabilities are not recognized because of the exceptions provided under APB 23, the following information is to be provided:

* The types of temporary differences and the events that would cause those temporary differences to become taxable.
* The cumulative amount of each type.
* The amount of unrecognized deferred tax liability for any undistributed foreign earnings, or a statement that such a determination is not practicable.
* The amount of unrecognized deferred tax liability for other temporary differences that arose prior to the period for which application of this statement is first required for each of those particular differences.

SFAS 109 requires following information to be disclosed about amounts allocated to continuing operations for each year for which an income statement is presented.

- Current tax expense or benefit
- Deferred tax expense or benefit
- Investment tax credits
- Government grants
- The benefits of operating loss carry forwards
- Tax expense that results either from allocating certain tax benefits directly to contributed capital or from allocating them to reduce goodwill or other non current intangible assets of an acquired entity.
- Adjustments to the deferred tax liability or asset for enacted changes in tax laws or rates or a change in the tax status of the enterprise.
Adjustments to the beginning of year balance of the valuation allowance because of a change in judgement about the realizability of the related deferred tax asset in future years.

SFAS 109 also requires disclosure of:

- The amounts of income tax expense or benefit allocated to financial statement elements other than continuing operations (e.g., discontinued operations, extraordinary items and retained earnings).

- The amounts and expiration dates of operating loss and tax credit carry forwards for tax purposes.

- The amount of the valuation allowance for which subsequently recognized tax benefits will reduce goodwill or other non-current intangible assets of an acquired entity or will be allocated to the equity accounts.

- A reconciliation using percentages or dollar amounts of income tax expense or benefit attributable to continuing operations with the amount that would have resulted from applying regular federal statutory tax rates to pre-tax income from continuing operations is required for publicly held companies only. Other entities, must however, disclose the nature of significant reconciling items.

Indian GAAPs do not require such detailed disclosures. However, the ICAI has come up with a guidance note on income taxes. The guidance note contains certain recommendations regarding the disclosure of certain
information in this regard, viz., (a) the accounting policy regarding the
treatment of taxes on income should be disclosed; (b) the tax charge for the
period should be included in the determination of net income of the
enterprise; (c) deferred tax balance should be presented under a separate
heading in the balance sheet of the enterprise, separately from the
shareholders' interest.

* Leases

A lease involves an agreement conveying the right to use property,
plant or equipment usually for a stated period of time. US GAAPs require
comprehensive disclosure requirements for lease transactions. SFAS 13 is
the promulgated GAAP for lease accounting. Lease transactions are
generally classified into operating and capital leases. A lease is a capital
lease if it meets one or more of the following criteria:

- Lease transfers ownership of the property to lessee.
- Bargain purchase option.
- Lease term is equal to 75% or more of economic life of leased
  property.
- Present value of minimum lease payments exceeds 90% of the fair
  value of the property at inception of the lease.

A lease that does not meet one or more of the capital lease criteria
will be operating lease.

As per US GAAPs, following disclosures should be made in the
books of lessee:
Operating Leases
For non-cancellable leases with lease terms of more than 1 year.

- Future minimum rental payments in the aggregate and for each of the 5 succeeding fiscal years.
- Total of minimum rentals to be received under non-cancellable subleases.
- Rental expense for each period an income statement is presented.
  Separate disclosure of minimum rentals, contingent rentals and sub-lease rental income.
- General description of lessee's leasing arrangements.

Capital leases

- Gross amount of assets recorded under capital leases by major class of asset.
- Future minimum lease payments in the aggregate and for each of the 5 succeeding fiscal years with deduction for amount of imputed interest.
- Total of future minimum sub-lease rentals.
- Total contingent rentals for each period an income statement is presented.
- Assets recorded under capital leases, accumulated amortization and related obligations separately identified in balance sheet or footnotes.
- General description of leasing arrangements.
In the books of Lessor:

**Operating leases**

- Cost and carrying amount of leased property by major class of property.
- Accumulated depreciation in total.
- Minimum future rentals on non-cancellable leases as of date of latest balance sheet and for each of the 5 succeeding fiscal years.
- Total contingent rentals included in income
- General description of lessor's leasing arrangements.

**In the Books of lessor :**

**Capital Leases**

For sales-type and direct financing leases:

- Components of the net investment in sales-type and direct financing leases as of each balance sheet date.
- Future minimum lease payments with separate deductions for executory costs included in minimum lease payments and accumulated allowance for uncollectible minimum lease payments receivable.
- The unguaranteed valued accruing to the benefit of the lessor.
- Initial direct costs (for direct financing lease)
- Unearned income.
- Future minimum lease payments to be received for each of the 5 succeeding fiscal years.
- Total contingent rentals included in income.
While the US GAAPs disclosure requirements are quite comprehensive for lease transaction, Indian GAAP is lagging behind. No accounting standard has been issued on the subject so far. However ICAI has issued guidance notes on the subject. The guidance note gives certain recommendations regarding the disclosure of lease information in the books of lessor and lessee. These recommendations are as follows:

**Disclosure in the books of Lessee**

**Finance Leases**

- A Lessee should disclose assets taken under a finance lease by way of a note to the accounts, disclosing, interalia, the future obligation of the lessee as per the agreement.
- An appropriate charge of lease rentals in the profit and loss account with a separate disclosure thereof.

**Operating Leases**

- An appropriate charge of lease rentals in the profit and loss account with a separate disclosure thereof.

**Disclosure in the books of lessor**

**Finance leases**

- Assets leased under finance leases should be disclosed as 'assets given on lease' as a separate section under the head fixed assets in the balance sheet of the lessor.
- Lease rentals under a finance lease should be shown separately under 'Gross Income' in the profit and loss account.
- A matching lease charge should also be made against the lease rental in the profit and loss account.
Operating leases

- Assets should be treated by the lesser as a fixed asset and disclosed in the balance sheet.
- Rental receivable should be included in income over the lease term.
- Costs including depreciation, incurred in earning the rental income should be charged to income.

Apart from the above disclosures, the lessor should disclose the accounting policies followed with regard to accounting for income under finance lease, valuation of assets given on lease and charge for depreciation.

* Pension Plans

The US GAAPs provide for comprehensive disclosure requirements for employees' pension plan. SFAS 87 and 88 are the sources of GAAPs in the pension area. The principal emphasis is on the disclosure of the present value of the pension obligation, the fair value of plan assets and make-up of net pension costs and projected benefit obligation. Separate disclosure requirements have been specified for defined benefit plans, defined contribution plans and post-retirement health care and life insurance benefits.

On the other hand, the Indian GAAPs do not prescribe such disclosure requirements for pension plans. The AS-15 on accounting for retirement benefits in the financial statements of employers prescribes certain information to be disclosed in this regard. According to this standard, the financial statements should disclose the method by which retirement benefits costs for the period have been determined. In case the
costs related to gratuity and other defined benefit schemes are based on an actuarial valuation, the financial statements should also disclose whether the actuarial valuation was made at the end of the period or an earlier date. In the latter case, the date of the actuarial valuation should be specified and the method by which the actuarial for the period has been determined should also be briefly described, if the same is not based on the report of the actuary.

The above discussion reveals that there is a wide gap between the Indian and the US GAAPs with regard to the disclosure of information in corporate annual reports. The US GAAPs disclosure requirements are quite detailed and comprehensive and as compared to the Indian GAAPs requirements. The need of the hour is to narrow this gap between these two GAAPs. Only then the Indian corporate reports will be able to serve the real purpose which is expected of them in the modern era of liberalisation.