CHAPTER VIII

SUMMARY AND CONCLUSIONS

Accounting has been defined as "the process of identifying, measuring and communicating economic information to permit informed judgement and decisions by users of the information". The definition has two phases: i) identifying and measuring economic information and ii) communicating economic information to users for decision making purposes. The second aspect is, thus, related to the accounting process and is achieved by means of 'financial reporting'. In recognition of this need, there has been a continuous and continuing growth in the form, style and contents of corporate financial reporting all over the world with different degrees of success.

The corporate financial reporting, however, has improved tremendously since the turn of the century. In
the nineteenth century, the past dividend declared by companies was, perhaps, the only information that was available to the shareholders. Since then, the concept of disclosure has changed and expanded considerably in different ways in response to the evolution of corporate form of business organisation, statutory requirements and to protect the interests of shareholders.

It is significant to note that in spite of the progress mentioned earlier, much more remains to be done. There are certain users of these published corporate annual reports who are still showing their dissatisfaction with the overall quality and quantity of disclosure made therein. In the criticism they include: a) insufficient disclosure of relevant information; b) absence of uniformity in accounting policies and c) aggregation of items which excludes some desired details.

The present study aims at:

i) evaluating the disclosure practices in published annual reports of Indian private sector undertakings;

ii) examining the disclosure practices followed in some foreign countries and to make a comparison of it with Indian companies; and

iii) supporting measures for improvement in present disclosure practices.
Methodology

To fulfil the objectives laid down, two Schedules (A & B) have been prepared. Schedule A contains items required to be disclosed compulsorily as per Indian Companies Act, 1956. It has further been divided into four parts in order to make it more explicit and simple in studying the disclosure practices. It contains 31 items. All the items in the schedule have been chosen on the basis of the provisions of Indian Companies Act 1956. Schedule B lists items not required to be disclosed compulsorily as per law, but are important from users' point of view. It contains 9 items which have been selected on the basis of the primary study of available literature on the subject.

Annual Reports for the last five years i.e. from 1979 to 1983 have been selected as sample to explain the extent of disclosure and to suggest measures for improvement, if any, in disclosure practices. The purpose of taking a period of five years is to see the trend i.e. whether the extent

1 Items required to be disclosed compulsorily as per the provisions of Indian Companies Act 1956 are being termed as 'Compulsory Items'. Though the disclosure of the items is not compulsory in the strict sense of the term, yet according to the provisions of the Companies Act, certain items are required to be disclosed as far as they are applicable. The language of Sec.211 reads as under:

Sec.211 provides that the 'Balance Sheet' shall give a true and fair view of the state of affairs of the company as at the end of financial year and shall be in the prescribed form set out in Part I of Schedule VI or as near thereto as circumstances admit or in such other form as may be approved by the Central Government generally or in any particular case.

According to Sec.211(2), every Profit and Loss account of a company shall give a true and fair view of the profit and loss of the company for the financial year, and shall comply with the requirements of Part II of Schedule VI, so far as they are applicable thereto and disclose information accordingly.

2 These 31 items with all possible sub-items make 90 in total.

3 The 9 items including all sub-items make 52 in total.
The number of companies in the selected sample is 51. All these companies have been chosen from the list of top companies in private sector on the basis of total capital employed given by 'The Economic Times' in 1982. All the sample companies have the following characteristics:

01 All sample companies are manufacturing companies.
02 All companies are multi-product firms, using different types of raw-materials.
03 All the companies are public Ltd. companies.

In order to determine the applicability of information items for Schedule A, Indian Companies Act 1956 has been consulted. It has further been noticed on investigation that items of information required to be disclosed in annual reports containing financial statements under Indian Companies Act are applicable to the companies if they have been disclosed in their annual reports. If they have not been found disclosed in annual reports, it indicates that such items are not applicable to the companies.

Generally, companies do not mention the item in the annual reports, which has nil information. For Schedule B, it has been assumed that all items of information therein are applicable to all the companies selected for study as every item is supposed to be useful to investors in making economic decisions. Besides these, the study of the disclosure practices in some foreign countries has been made and
compared with Indian practices. The number of countries selected for study is 64. For comparison, four tables have been prepared. First table includes items shown on the liabilities side of Balance Sheet; Second is meant for items shown on the assets side of Balance Sheet; Third consists of items shown in Profit and Loss Account; and the last table lists items other than the profit and loss account and balance sheet which are supposed to be useful for investors in making economic decisions.

Findings

The findings of this study relating to corporate financial disclosure practices in respect of compulsory items show that there is an improvement in disclosure practices over years. For instance, the total disclosure has been 87.28% in 1979 while in 1983 it has increased to 89.68%, showing an improvement of 2.40% in disclosure practices in respect of all items over 1979 to 1983. The results of this study relating to corporate financial reporting practices in respect of non-compulsory items show that items relating to graphic and diagrammatic presentation have the highest disclosure percentage in corporate annual reports of all the sample companies in all the five years chosen for study (i.e. 52.94%, 52.94%, 60.78%, 64.71% and 69.93% for the years 1979 to 1983 respectively). This is because, companies perhaps think that presentation of business results such as sales, production and profit through diagrams, graphs etc. will give a more clear picture to the investors.
which help in influencing the investment decision of potential users. Disclosure through ratios are not quite popular and accounted for the lowest disclosure percentages almost in all the years under study. This is because, showing of business results through ratios are not easily understood by all the investors. This will, particularly, create a problem for users who are not educated enough. Observing the overall position of disclosure of voluntary items, it has been noticed that there is a slight improvement to 20.34% in 1983 over 19.31% in 1979.

On the basis of above findings, it can be said that a large number of items like:

- Ratios, such as current ratio, quick ratio, inventory turnover ratio, profitability ratio, gross profit to sales, net profit to sales, earning per share, dividend payout ratio;
- capital and research expenditure; information about major products produced; information on performance budgeting; information on labour contracts; extent of dependence upon a few customers; summarised statements such as cost of goods sold, gross profit, net profit, net worth; bonus shares to employees etc.

have not been presented in majority of the corporate annual reports covered by this study.

It has further been observed that there are certain other items such as:
Budgeted forecasts; budgeted earning per share; cash budgeting projections; rates of absenteeism among employees; productivity; inflation adjusted accounts; cash-flow statements; value added statements; segmented disclosure (both in profit and loss account and balance sheet), contribution form of profit and loss account; directors' outside affiliation and information about arrears of sales orders, which have not been disclosed even by a single company under study.

The findings of the study relating to corporate financial disclosure practices of some foreign countries selected, show that the items relating to balance sheet (both liabilities and assets sides) and profit and loss account have been shown almost by all the countries because these items are compulsorily required to be disclosed by law almost in all the sample countries. Disclosure regarding other items have been made only by a few economically advanced countries like United States; United Kingdom; Hong Kong; Canada; Singapore etc. In addition to this, certain information useful to investors have been revealed in financial statements voluntarily, though there is no legal obligation even by some economically backward countries like Bahamas, Nigeria, Portugal, Fizi etc.
Contribution of the Study

The Companies Act 1956 as amended from time to time has made it obligatory on the part of the companies to give a greater degree of disclosure of their state of affairs in the annual accounts. It is true that most of the companies publish only what is required by law. But a few of the progressive concerns like Tata Group of Companies, Gwalior Rayon, National Organic etc., which have always been ahead of the law and have paved the way to progress for other companies, give much more than this, and their efforts have been to provide the maximum information to the investors through schedules, charts, graphs, diagrams, tables and other supplementary statements. On the contrary, there are other companies which even avoid the minimum disclosure required by law.

After having a glimpse of the annual reports of 51 companies, chosen for study, the following shortcomings have been noticed:

01 The balance sheet prepared on the lines of Schedule VI has been burdened with a lot of information, but the classification and grouping of assets and liabilities (according to Schedule VI of the Companies Act 1956) lacks clarity and sometimes causes confusion. It is suggested that the balance sheet should give clear indication of net worth on the one hand (i.e. contributed capital, capital reserves, revenue
reserves and surpluses), borrowed money, liability funds (e.g. Employees' Pension and Provident Funds), provisions and current liabilities and, on the other hand, of fixed assets, investments, current assets etc. To simplify the Balance Sheet and make it look clean and understandable to all the users, the appending of the following schedules should be made compulsory:

a) Schedule of Fixed Assets.
b) Schedule of Investments.
c) Schedule of Reserves and Surplus.
d) Schedule of changes in Working Capital and a statement of Source and Application of Funds.

02 Schedule VI of the Companies Act 1956 provides a format for the Balance Sheet, but no specific format is prescribed for the preparation of the Profit and Loss Account. The emphasis is, therefore, not on income estimation, but on the general economic position of the corporate undertaking.

03 The Final Accounts prepared and presented according to Schedule VI do not give a fair presentation of the profitability and the financial status of the company. It is because they are based on historic cost and as such, the effect of inflation is not reflected in them.

04 No distinction has been made between tangible and non-tangible assets under the Companies Act 1956. Both the
types are clubbed together and shown under one head "Fixed Assets". If the intangible fixed assets like goodwill, trade-mark, patent etc. have no value, the facts should be disclosed separately in financial statements. Further, the fixed assets should at least once in every ten years be valued by a valuer, whose report should be attached to the balance sheet. This will enable the true-worth of the business to be fairly judged.

05 According to the requirements of Companies Act, accumulated depreciation provision for each asset is deducted from the cost of each fixed asset. It is not going to give an idea of the adequacy of the depreciation as the age composition of the asset is not required to be given according to Schedule VI. Further, there is no such requirement under the Act to disclose the method of providing depreciation in the financial statement. It is suggested that disclosure of method of depreciation should be made compulsory.

06 Under the head 'Investment', no distinction has been made between trade and non-trade investments, which is desirable and should be made compulsory by law. Non-trade investments should be shown separately. Trade investments should be classified as to:

i) Permanent trade investments

ii) Temporary trade investments

Permanent trade investments should be included under fixed assets and temporary trade investments should be included in current assets.
On the basis of Schedule VI, sundry debtors are required to be shown in the Balance Sheet of a company in two categories, namely, debt outstanding for a period exceeding six months, and other debts. Debts shown according to this age composition will not give a clear idea about their collectibility. A suggested approach to classify the book debts according to the age is to divide them into two broad categories, namely; debts outstanding for a period exceeding the credit period allowed, and debts outstanding for a period less than the credit period allowed. A note should be given about the credit period allowed.

Besides these, the statute should provide the dissemination of the following information:

a) All relevant information and material facts that are likely to influence the decisions of the users of the financial statements should be disclosed. There should be no distortion of facts so that the users of these statements may not be misled.

b) Standing commitments in respect of future contracts should be given.

c) Commitments in respect of purchases or sales of investments, and capital expenditure other than those shown in the balance sheet be given.

d) Detailed amount of the interlocking of company's funds be given.
e) Amount of long-term liabilities repayable within the next accounting period should be shown under the heading current liabilities.

f) Contingent assets should also be disclosed by way of note to the Balance Sheet like Contingent liabilities.

g) Assets and liabilities should be shown according to the permanence order in the Balance Sheet. In this order, the most durable assets and liabilities are set out first, comparatively less durable one next; and so on. The permanence order of showing assets and liabilities is in conformity with the basic characteristics of the company form of organisation. Because, a company is expected to survive long unruffled by the death of insolvency of its members. However, a company, once established, is expected to be a permanent organisation and this feature has been reflected in the form of the balance sheet prescribed by law.

Further Suggestions

To enhance the usefulness of financial reporting and to provide maximum available information to the investors, following suggestions should be kept in mind by companies while preparing the final accounts:

01 Provision of Important Ratios

The companies should show some of their operational results by calculating ratios such as current ratio, liquid ratio, quick ratio, inventory turnover ratio, profitability ratio etc. This will help the users in understanding of companies' operations in more explicit
way. For instance, on the basis of liquid ratio, an investor can judge whether a company possesses sufficient cash to meet its day-to-day obligation or not.

02 Publication of Statistics
Companies should publish statistics to show various aspects of their working, which would be of interest to the shareholders. Some of the matters of which statistics should be given are:

a) The value of shareholders' equity (i.e. net worth per share).

b) Percentage of net profits after taxes to the shareholders' equity.

c) Number of employees.

d) Number of shareholders.

e) Dividend per share paid.

All the statistics should be at least for five years so that a view of trend can be seen.

03 Use of Charts, Graphs and Diagrams
Presentation of certain information through charts, graphs, diagrams etc. increases the understandability of the information. The following items should be shown through these ways:

a) Break-up of earnings into consequent items of expenditure, in the form of pie-charts or diagrams.
b) Break-up of sales as percentages of different products sold either in the form of pie-charts or "rupee-break-up" diagrams.

c) Bar diagrams or graphs showing the increase in production, sales, profit etc. from year to year.

d) Tabular presentation of dividends declared and percentage of dividends to invested capital.

e) Pie-Charts or diagrams showing the break-up of the shareholding in terms of units of shares held per person.

04 Preparation of Funds-Flow Statements
Companies should prepare funds flow statements along with other financial statements as it will help the users in knowing:

a) To what extent funds are becoming available to the company and have been invested in either fixed or working capital.

b) The amount and proportion of funds generated within the company.

c) The changes in net liquid funds of the company, which otherwise is not possible.

05 Segmented Disclosure in Annual Accounts
A company should make reporting about its each segment separately, if it engages into different product lines. This will provide users of financial
statements with information on the relative size, profit contribution, and growth trend of different segments which otherwise is not available from aggregated data.

06 Human Resource Accounting
An attempt should be made by every concern to put a value on human resources (i.e. on skill, experience of labour force). Human resources are actually more important than even physical resources as without them physical resources will remain unutilised.

07 Value Added Statements
Value Added Statements should also be prepared by companies so that the shareholders have a clear idea about the value added by production.

08 Contribution form of Profit and Loss Account
Information relating to cost-volume profit relationship should be reflected by the financial statement which will aid the investors and management in making rational economic decisions. The predominant feature of this form of income reporting is the relationship between variable costs and sales. The complement of this relationship, i.e., the variable margin ratio can be adjusted for expected changes in selling prices and costs and then applied to expected sales for the coming years to ascertain the revenue margin available for fixed costs and profit.
Therefore the profit and loss account should be prepared in contribution margin form by the companies. The suggested format has been given below:

**EXHIBIT 8.1**

Sales

Less: Variable Costs:
- Manufacturing, selling and distribution

Contribution Margin

Less: requiring current funds (Rent, Adm., and development)

Less: Fixed costs not requiring disbursement of funds (Depreciation etc.)

Profit

Add: Gain on sales of fixed assets
Non-operating gains

Net profit

The technique of presenting the profit or loss of business through contribution margin form will provide the management with another important measurement: "Funds generated from operations". This type of Profit and Loss Account, thus,
would seem to be more useful than the traditional one.

09 **Disclosure of Accounting Policies**

Companies should disclose various accounting policies such as:

a) Methods of Depreciation
b) Treatment of goodwill
c) Treatment of contingent liabilities, in the final accounts.

10 **Salient Features of the Company**

Company should give separately all the salient features so that shareholders can have quick idea about the financial position and profitability of the concern. The following is the suggested format showing important features of a Company.

**EXHIBIT 8.2**

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<th>1st Year</th>
<th>IIInd Year</th>
<th>IIIrd Year</th>
<th>IVth Year</th>
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</thead>
<tbody>
<tr>
<td>Return on capital employed</td>
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<td>IIIrd Year</td>
<td>IVth Year</td>
<td>Vth Year</td>
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<tr>
<td>Gross Profit to sales</td>
<td></td>
<td>IIIrd Year</td>
<td>IVth Year</td>
<td>Vth Year</td>
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<tr>
<td>Operating Profit to Sales</td>
<td></td>
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<td>IIIrd Year</td>
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<tr>
<td>Turnover</td>
<td></td>
<td>IIIrd Year</td>
<td>IVth Year</td>
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<tr>
<td>Profit before taxation</td>
<td></td>
<td>IIIrd Year</td>
<td>IVth Year</td>
<td>Vth Year</td>
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<tr>
<td>Taxation</td>
<td></td>
<td>IIIrd Year</td>
<td>IVth Year</td>
<td>Vth Year</td>
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<tr>
<td>Dividends</td>
<td></td>
<td>IIIrd Year</td>
<td>IVth Year</td>
<td>Vth Year</td>
<td></td>
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<tr>
<td>Profit for the year retained in the business</td>
<td></td>
<td>IIIrd Year</td>
<td>IVth Year</td>
<td>Vth Year</td>
<td></td>
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<tr>
<td>Capital employed (Share capital, reserve &amp; surplus, expenditure on fixed assets)</td>
<td></td>
<td>IIIrd Year</td>
<td>IVth Year</td>
<td>Vth Year</td>
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</tbody>
</table>
11 Preparation of Cash-Flow Statement

Cash flow statement should be prepared by every concern and presented in the Annual Reports so that the shareholders be acquainted with the cash position of the concern.

12 Presentation of Final Accounts in Vertical Form

Vertical form of presentation of final accounts (i.e. both Balance Sheet and Profit and Loss Account) is better than the Horizontal Form on the following grounds:

a) It can be readily understood by a layman.

b) The balance sheet prepared in vertical form discloses the amount of debt and shareholders' equity distinctly.

c) It further shows the position of assets and working capital separately.

d) This form is capable of presenting together comparative figures for a number of years. The relationship between the various balances for the current year can be disclosed in the form of accounting ratios by placing the relative data in closer proximity. Hence the companies should present their final accounts in Vertical Form.
Introduction of Price-Level Changes in Final Accounts

The preparation of inflation accounts either as part of companies' audited accounts or as a supplement to them is becoming necessary for companies now-a-days. This will give the investors the exact picture of company's activities based upon the current price index. Three types of solutions are suggested for giving recognition to inflation in financial statements:

i) Financial information could be prepared in terms of current values instead of historical costs. The technique is known as current cost accounting.

ii) Financial information could be prepared on the basis of historical cost but with amounts stated in terms of current purchasing power of rupee. This system is known as current purchasing power method.

iii) Financial information could be prepared by combining features of each of the two approaches given above.

Out of the various methods of accounting for changing prices, the Current Cost Accounting is supposed to be most appropriate in the context of the economic environment in India. It is a rational and comprehensive system of accounting for changing prices as it considers the specific effects of changing prices on individual enterprises and thus ensures that profits are reported only after maintaining the operating capability.