CHAPTER I
INTRODUCTION

Knowledge of result and its effect on human behaviour are essential themes of a text concerned with the issues and problems associated with the production, communication and use of financial information. The transformation of Joint Stock Companies from just legal business entity to socio-economic institution has evoked interest of various sections of the society in knowing working results and financial structure of companies—both in Private and Public Sectors. The performance of economy depends not only on increasing the amount of capital, labour, skills and other resources available or employed, but also in their better allocation between alternative uses on the basis of the decisions made by firm, public body, government and
individuals as consumers, businessmen, civil servants or politicians. The quality of these decisions which determines inter-alia the pattern of production, the nature and direction of investment, the selection of techniques, the location, training and forms of employment and the formulation of public policy must depend largely on the quantity and quality of information available and its uses by and within decision-making units ranging from the smallest family to the largest public corporation.

Modern economic growth, to a considerable extent, depends upon the independent actions and reactions of a very large number of consumers, investors and businessmen. Therefore, economic information should be available in such a form that these interested parties having diverse economic interests are capable of supporting their actions in a logical and rational manner. There are many aspects of the economic information needed for the purpose. The most important aspect is the reporting of economic success or failure of the economic units that control and use the substantial portion of the scarce capital resources of the country. Reporting is nothing but the communication of accounting information of an entity (individual, firm, company, government enterprise) to a user or group of users. Generally the term 'financial disclosure' connotes communication of
published financial information from an enterprise to third parties including shareholders, creditors, customers, governmental agencies and the public.

The American Accounting Association Committee in 'A Statement of Basic Accounting Theory' has stressed the significance of disclosure while defining accounting as "the process of identifying, measuring and communicating economic information to permit informed judgement and decision by users of the information". Three concepts of disclosure generally proposed within the financial accounting area are: adequate, fair and full disclosure. These terms are indicative and relative and not definite. Among these three concepts, the most commonly used is adequate disclosure. This implies a minimum amount of disclosure so that financial statements may not be misleading. Adequate disclosure reflects the economic efficiency of the use of resources and thereby helps in directing the flow of capital into the most productive channels. Therefore, if an economic society is to function effectively, it is essential that this disclosure should be an adequate measure of economic performance. It should be reliable and be presented in a fashion meaningful for the concerned parties. 'Fair and full' are more positive concepts. Fair disclosure implies an ethical objective of providing equal treatment to all potential users. Full disclosure implies the presentation of all relevant
information. However, it is contended that there is no difference among these concepts, if they are used in the proper context.

The quantity and quality of corporate financial disclosure have improved tremendously since the turn of the century. In the nineteenth century, the dividend declared by a company was generally the only information that was made available. Since then much improvement has taken place in disclosure practices on account of various compelling pressures, such as, the enactment and modification of disclosure laws by the modern welfare states for the protection of the interested parties, the expansion and growth of the corporate forms of business organisation and the emergence of accounting as a recognized profession.

A review of relevant literature relating to the area of the Accounting and Finance suggests that on one hand, company managements have, by and large, enhanced the meaningfulness of the annual reports by improved disclosure, and on the other, there are many users of these published corporate annual reports who are still showing their dissatisfaction with the overall quality and quantity of disclosure. Most scholars, in fact, claim that the information is inadequate and sometimes even misleading. More specific criticism includes: (a) insufficient disclosure,
of relevant information, (b) disuniform employment of alternative methods, and (c) aggregation of items which excludes some desired details.\(^1\) In short, the literature claims that corporate disclosure practices are less than satisfactory.\(^2\) Moreover, the extent of disclosure can vary from company to company. In some annual reports, there may be more information than in the others.

**Objects of the Study**

Corporate annual report is the most important source of information on the company because it indicates its general conditions. The present study, therefore, is based on the entire annual report and not merely on the audited financial statements contained therein.

The objectives and scope of the present study are:

1) To evaluate the disclosure practices in published annual reports of Industrial Giants in India in the private sector by measuring the extent of disclosure;

2) To examine the disclosure practices followed in some foreign countries and to make a comparison of it with Indian Companies; and

---


iii) To support measures for improvement in present disclosure practices.

**Hypothesis**

1) We have assumed that all information disclosed in annual reports of all the companies under study are according to the Schedule VI of the Companies Act. They contain all provisions as regards disclosure prescribed in Part I and II of Schedule VI respectively.

ii) It is assumed that the companies by and large do not disclose the information which are not to be disclosed compulsorily according to the requirements of the company law.

**Reasons for the above assumptions**

1) The basis for assumption is that all the companies disclose the information required as per the law is quite natural and logical. The companies fear that violation of law would attract penal proceedings.

ii) The hypothesis that the companies normally do not disclose any other information except those required as per law is based upon the observation that management is conservative, it wants to hide as much information as possible. Moreover, it does not realize the importance of disclosure to the shareholders. It fears competition also.
Methodology

To accomplish the objectives laid down earlier, two Schedules (A & B) have been prepared. Preparation of Schedules of disclosure has been discussed in details in Chapter V and VI. Schedule A contains items required to be disclosed compulsorily as per Indian Companies Act 1956. It has further been divided into four parts for the sake of clarity and simplicity in a critical study of the disclosure practices. It contains 41 items. All the items in the schedule have been chosen on the basis of the provisions of Indian Companies Act 1956. Schedule B consists of items not required to be disclosed compulsorily as per law, but are important in the interest of the users. It contains 9 items which have been selected on the basis of the primary study of available literature on the subject.

3 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:

Section 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 Section 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 there-to and disclose information accordingly.

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

5 The 9 items of information along with the sub-items make 52 in total.
Annual reports for the last five years i.e. from 1979 to 1983 have been studied in order to explain the state of art (extent of disclosure) and to suggest measures for improvements, if any, in disclosure practices. 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:

i) All sample companies are manufacturing companies.

ii) All companies are multi-product firms, using different types of raw-materials.

iii) 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 1956, are applicable to the companies if they have been revealed 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. Further, for Schedule B, it has been assumed that all items of information therein are applicable to all the sample companies as each and every item is essential from users' point of view.
Scope of the Study

The following points define the scope of the present study:

Firstly, our study is limited to disclosure in published corporate annual reports only. Other sources of information, such as friends, brokers, business magazines, annual meetings etc., have not been taken into consideration.

Secondly, the present study has included the annual reports of manufacturing companies in private corporate sector only. Therefore, it does not include insurance companies, banks, investment companies, finance companies, public utility concerns and public sector enterprises.

Thirdly, since companies are allowed to choose their own accounting dates, they show little conformity in maintaining common ending date. A large number of sample companies have chosen 31st March as the date of closing while a significant number of companies have chosen 31st December. In preparing this data, a company is included for study irrespective of the date it has chosen as the closing date.

Fourthly, the study is concerned with the informational needs of primary users making economic decisions. There are other groups also which use the corporate annual reports, but their informational needs are sub-ordinated to the data needs of economic decision makers. Therefore, the informational needs of these secondary users have not been specifically examined in this study.