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A DECADE OF FINANCIAL REPORTING IN INDIA

CORPORATE reporting has a two fold aspect—internal and external. It is this dual aspect which distinguishes corporate reports from reports of other types of organisations.

THE HISTORICAL FACT ABROAD

A study of the history of financial reporting shows how the corporate reports have been influenced by 'conventions' as well as by 'law'. It is also interesting to note how an organised accounting profession can set the pace for wholesome accounting practices leading to efficient reporting. American history highlights the unfettered growth of reporting, with the Securities Exchange Commission laying down guidelines in the form of principles which are only recommendatory in nature. In England too the role of the accounting body in raising the standards of reporting has been commended by the Jenkins Committee in its report thus : "The recommendations on accounting principles periodically issued by the Institute of Chartered Accountants in England and Wales to their members have already done much to ensure that the standards of accounting are reasonably uniform and constantly rising. These recommendations are based on close and constant study of the relevent problems which are ever changing and it is primarily to the initiative of the professional association that we must look if the general principles of the Act are to be effectively applied in practice". [1]

INDIAN HISTORY

The accounting profession in India though in its infancy has contributed in its own way to the development of reporting.

It would be worthwhile to study the development of reporting though on a random sample basis, over a decade to assess the direction and pace of progress. The study would also indicate the influence of various factors like law, conventions, professional expertise etc., in the progress of reporting. With this view a careful study of the trends in reporting techniques and disclosure of material particulars of 20 public companies selected at random has been made. The companies whose annual reports were studied happen to include 9 'managing agency managed' and 11 'directors' managed companies'. Three annual reports of each of the companies were studied, one of a year immediately before the 1956 Companies Act (1954), second of a year soon after 1956, (1958) and the third of a year in sixties (1965). Thus it was sought to view the trend in reporting techniques and disclosure of material information over a decade. The observations can be classified broadly into those on (1) Techniques of reporting and (2) Disclosure of material particulars.

OBSERVATIONS ON THE TECHNIQUES OF REPORTING

It is difficult to decide whether a certain aspect of reporting is a 'technique' or not. Certain pieces of information would get prominent disclosure if certain techniques are adopted. It is also possible through suitable techniques to conceal vital facts.

It is a fact that 'techniques' are not static. Thus it is difficult to identify a set of wholesome techniques which aid in better reporting. However taking into account the state of the Indian economy in the social background, as opposed to western countries, the following minimum factors can be considered as means to measure the standards of reporting : [2]

(*i*) The general get up of the report and the skilfull use of colours,
(*ii*) the use of special effects like graphs and charts,
(*iii*) aesthetic use of the covers of the report,
(*iv*) the form of presentation of the financial statements,
(*v*) meaningful grouping of the items of the revenue statement.

(i) General getup and use of colours

As compared to 1954, only 7 companies out of the 20 had improved the general getup of their reports in 1958. However in 1965, there was a noticeable improvement in the general getup in 14 companies over their 1958 presentation. This indicates the developing consciousness in handy nicely gotup reports. In judging the getup of the reports, the physical size, the colour used in the covers, the quality of paper used and the types used for printing words and figures have been taken into account.

As regards the use of colours, before 1956, only one company out of the twenty used different coloured inks for their figures. All the others were just printing their reports in black on white. In 1958 however some of the companies started using diffrent colours for the figures. The number of companies in this category was 3 in 1958. In 1965, this number rose by only one. Thus the trend is that the reports have remained a colourless and unattractive document on the whole.

In both the above factors the companies managed by managing agents were far ahead of those managed by the directors.

(ii) Use of special effects

Before 1956, none of the companies used any illustrations or charts to portray the information in an easily assimilable form. In 1958 one company managed by managing agents had used certain tables showing the growth of the company since its inception The tables showed comparative balance sheets and profit and loss accounts for the various years. There was also a separate table showing the percentage of dividend declared over the various years since its inception. In 1965 the number of companies in this category rose up to two, the first mentioned company continuing the same tables. The increase in number was due to another company again managed by managing agents presenting certain graphs showing the trend of salaries paid, production achieved, gross profit and net profit earned over a period of years. All the other companies chose to limit themselves to the presentation of information strictly required by law.

(iii) Aesthetic use of the covers of the report

Before 1956 none of the companies used the inner face of the front cover and both the faces of the back cover. The outer face of the front cover was used invariably for printing the name of the company, year of report, names of the directors, managing agents, Auditors, solocitors, the registered office and the name of the printers. Thus 8 out of the 20 companies crammed the outer face of the front cover with all the above particulars. In 1958 the, number of those who so crammed the front cover was reduced to 7. In this year one company (managed by managing agents) made good use of the back cover. On its back cover appeared colourful pictures of the company's products. In 1965, the number of companies who crammed the front cover was reduced to 3. In this year there was a noticeable trend towards tatsteful decoration of the outer faces of both the coevers. Thus the general trend now is tasteful decoration of the outer covers.

(iv) The form of the financial statements

In this matter the discretion of the companies is limited, They had to present the accounts in the form prescribed. Of late the Company Law Board has started giving permission for presentation in any suitable form other than that prescribed in Schedule VI. However it can be said that the Companies Act did not and does not prevent companies from presenting statements in other forms also. Thus such a practice would indicate the company's desire to better appraise its constituents.

In the above light when the reports were analysed, it was found that before 1956 none of the companies wanted to do more than what the law expected of them. The same tendency continued after 1956 also execpting that one company showed two statements, one showing financial position on a summary form containing shareholders' net worth (tangible assets less liabilities) and it being represented by capital and surplus. The other statement was a summary of the trading results in a nutshell showing how income was earned and applied. It is a sad commentary that the very same trend continued in 1965 also. In this year too only one company chose to give the two statements referred to above in addition to the statutory balance sheet and profit

and loss account. The company which adopted the special presentation in 1958 however gave it up in 1965. Both the above companies were managed by managing agents.

This is a field where the accountants could and should have done something. It is necessary for the accounting body to give serious consideration to the above.

(v) *Grouping of the Profit and Loss Account items*

Most of the companies did not group the expenses and income at all. This feature of the pre-1956 reports was found to be on the decline in 1958 and 1965. However most of the companies even now do not do any organised grouping. The grouping is haphazard. Moreover it was also observed that there was absolutely no uniformity in grouping of items from year to year. The result being the difficulty to compare yearly figures. A separate trading account was not prepared in many companies though a separate profit and loss appropriation account was prepared. In these days when cost accounting records are being enforced on manufacturing companies, the accounting profession can very well depict the income and expenditure in an organised fashion showing the gross and net profits separately without at the same time disclosing material information to competitors. The profession is free to do it. It has the facility to do it as it has two wings of membership : (*a*) practising members and (*b*) those engaged in industries. If it does not use that freedom in the interests of the shareholders, the blame lies squarely on the profession and not on the Government.

CONCLUSIONS ON TECHNIQUES OF REPORTING

Thus this part of the analysis can be concluded with the following remarks :

(*a*) There had been all round efforts to improve the physical size and get up of the reports over the decade.

(*b*) Companies chose to adopt generally the techniques as required by law and did not try to do more;

(*c*) In the areas where freedom was allowed to the accounting

profession to use its skill in the interests of the shareholders, the progress had not been quite encouraging;

(*d*) generally companies managed by managing agents adopted better techniques of reporting than the others.

OBSERVATIONS REGARDING MATERIAL DISCLOSURES

It is hard to fix definite measures of adequate financial disclosures. 'Financial reporting' as understood now is the submission of management before the general body of shareholders to enable the latter to critically analyse how the former had handled the affairs of the company. It is therefore a natural human tendency to withhold certain information or to mix up certain vital information with others so that they do not come prominently to the notice of the shareholders. Of course nothing is meant here to belittle the role of the auditors. Still such manipulations are possible though the auditors are prudent in the discharge of their duties.

What then are those pieces of information which may either agitate the shareholders or put the shareholders to enquiry ? In determining these, guidance has been mainly sought from :

(*a*) the changes in the disclosure provisions introduced by and in the Companies Act 1956.
(*b*) The report of the Jenkins Committee in England in 1962.
(*c*) The report of the Vivian Bose Commission of Enquiry.

In the above light, from the annual reports of the 20 companies, information regarding the following matters was searched for :

(*i*) the practice of lumping up number of items of expenditure or income as 'miscellaneous items' in the profit and loss account,
(*ii*) information regarding contracts with other individuals or concerns in whom/which the managerial persons are interested,
(*iii*) donations and the details of the donations,
(*iv*) disclosure of details of contingent liabilities and assets,
(*v*) particulars (non-financial information) contained in the directors' report.

(*i*) *Lumping up of number of items*

One of the methods of satisfying the law as well as to conceal facts would be to group up different items under 'miscellaneous' heads. Clause 3 of Part II of Schedule VI to the Companies Act states that the profit and loss account shall set out the various items relating to income and expenditure arranged under most convenient heads. This clause means by 'convenient heads', convenient for the purpose of classification and understanding.

While grouping certain items under a miscellaneous head, the major consideration should be 'materiality'. [3] But if a figure though insignificant is still controversial has to be shown separately.

Our study of the practice of 'lumping up' several items reveal interesting facts. Before 1956, 14 companies out of the 20 used the heads of 'miscellaneous expenditure' and or 'miscellaneous income'. Out of the 14, only one company listed out the material items constituting 'miscellaneous expenditure" The rest of the companies did not mention the break up of the 'miscellaneous' item anywhere. One of the companies had included income tax also under this head but did not mention the amount of the tax included therein.

In 1958, 16 companies used the head of 'miscellaneous expenditure' and 'miscellaneous income'. Out of them, one company had given details of some of the items of 'miscellaneous expenditure'. This company was managed by managing agents. One company continued to include income tax paid in 'miscellaneous expenditure" This company also was managed by managing agents'

In 1965, the same position as above continued. The company which included income tax in 'miscellaneous expenditure" continued to do so.

This omnibus head of expenditure and income is a potential instrument to conceal facts. It is therefore better that in the interests of the shareholders, the auditors should bring out the components of the items into open if any component therein is a controversial figure or a significant item i.e., exceeding a certain percentage under that head and if the miscellaneous head itself exceeds a certain percentage of the total expenditure.

(ii) Disclosure of contacts with allied concerns

The 1956 Companies Act tried to throw a considerably wide net by including provisions regarding transactions with companies under the same management. Still in 1960 and in 1965 substantial amendments had to be made in respect of inter-company loans, advances and investments. It is still however possible to siphon off funds by dealings at abnormal rates in the normal course of business. This may be done not necessarily 'under the same management'. The provisions of Clause 4(*v*) of Part II of Schedule VI to the Companies Act seeks to disclose only the money value of contracts for the sale or purchase of goods and materials or supply of services entered into by the company with the managing agent or his associates. It is difficult to understand why the managing agent alone should be singled out. Any contract entered into if material with any of the associates of the managerial personnel should come under the purview of this clause. Even here it would be only harassing the company if the details of evry such contract is to be stated. It is suggested that the matter should be left to the auditors. If the auditor finds that the rate is abnormal or the supply is out of turn (in the case of essential commodities) he should insist upon suitable notes. There is no use mentioning just the money value of these contracts. The margin made or lost is also important.

Our study in this connection did not reveal anything significant. The reason may be that the disclosure under the Act was limited to companies managed by the managing agents. In the post 1956 balance sheets no details regarding this are available in the reports of the 9 companies analysed. However one conclusion can be reached that in this regard the managements were strictly limiting themselves to the disclosures required under the Act.

(iii) Donations given and their details

One of the topics of the day in political circles is the political contributions by companies. The analysis here relates to donations in general and not limited to political donations alone.

Our analysis reveals that in 1954 out of the 20 companies, 11 had given donations (irrespective of the amount and the cause). The

number of companies giving donations rose to 12 in 1958 and in 1965 it became 14. The number of companies managed by managing agents in this category remained at 6 in 1954 and in 1958. The number went up to 8 in 1965. Though the charitable trend was upward over the decade, the disclosure trend was downward.

The following Table illustrates the position regarding donations :

Table Showing details of donations and their disclosure

Particulars	Number of Companies. 1954		1958		1965	
	M.A.	*Others*	*M.A.*	*Others*	*M.A.*	*Others*
Donations given (Particulars Disclosed)	2	—	1	1	2	—
Donations given (Particulars not disclosed)	4	5	5	5	6	6
TOTAL (i)	6	5	6	6	8	6
No Donations given (ii)	3	6	3	5	1	5
TOTAL (i) + (ii)	9	11	9	11	9	11

M.A.—Companies Managed by Managing Agents.

The majority of the donations was from companies managed by managing agents. The Companies Act does not spell out clearly the disclosure provisions regarding donations other than to political parties. It is necessary to take steps to ensure that the shareholders are adequately informed of the details of application of funds for purposes other than for the objects of the company however insignificant the amount may be.

(*iv*) *Dsiclosure of contingent liabilities and contingent assets*

Though even under the 1913 Act disclosure of contingent liabilities by way of notes was necessary, the 1956 Act has amplified the same further. It is a common fact that a member unless he is so calculative as to feel the effect of the contigent liabilities is not going to appraise the significance of item if it just appears in the balance sheet as a note. It is better to state that a buffer is available against the contingent liabilities if.there is one. This if shown in the form of a statement would be meaningful. This statement may be prepared if the contingent liabilities are material. Thus the statement may narrate the

shareholders' net worth which is chargeable against the contingent liabilities. If contingent assets are also there, the liability may be set against the asset. This suggestion has greater validity if we study it together with the report of the Jenkins Committee and the Vivian Bose Commission report. The Jenkins Committee had averred in its report that the directors may state in their report the potential profitability of certain fixed assets which have alternative uses.[4] This would obviate any one taking advantage of insider information in share market operations.[5]

Our study of the reports of the 20 companies reveals that no company had shown either in 1954, 1958 or 1965 any information regarding contingent assets. Regarding contingent liabilities too, before 1956 only 10 out of the 20 companies gave some information or the other. Out of this 10, 4 were managed by managing agents. Out of the other 10 companies which did not give any information regarding contingent liabilities, 5 were managed by managing agents. In 1958, 5 companies did not show anything as contingent liabilities. In this 5, 2 companies were managed by managing agents.

In 1965, 3 companies did not show anything as contingent liabilities. Out of the above, 2 belong to the managing agency category.

No definite comments could be made about the non-appearance of contingent liabilities. One could not hazard a guess when the auditor also has given a clean chit. However such cases are worthy of further study if information is forthcoming.

(*v*) *Directors' report*

The provisions contained in section 217 of the Companies Act do not spell out clearly the role of the Board's report. It seeks to emphasise the disclosure of non-financial information which do not feature in the financial statements. The Board's reports however over the years happen to be a 'colourless document' stating as a matter of routine, the profit earned, proposed dividend and the amount of profit to be carried forward. They mention few particulars by way of explanation in case the auditors' report contain any qualifications. As long as the company operates profitably the directors' report does not contain any other information than the above. Of late, all Board reports invariably state the general increase in price level and the rise

in the cost of production and also offer some adverse comments on Governmental policies.

The directors' report should serve as a useful supplement to the financial statements. There is no use if the same figures are restated there also.

In the above light, our analysis of the reports, before 1956, indicates that out of the 20 companies, 8 did not give any non-financial information. The figures appearing in the financial statements were restated in the directors' report also. Out of the 8 two were managed by managing agents. The position had improved in 1958. The companies which just used financial statement figures and nothing else, numbered only 3. No company managed by managing agents was found in this 3. In 1965, only two companies had practically given no non-financial information. Both these companies were managed by the boards of directors.

In the matter of information disclosed, it can not be said whether they were adequate or not. It has also not been endeavoured to study the reasons for greater non-financial information.

CONCLUSIONS ON MATERIAL DISCLOSURES

(1) Generally companies do not want to disclose more than what the law expects them to do.

(2) The practice of application of shareholders' funds in non-business channels should be disclosed clearly in the profit and loss account irrespective of the amount involved.

(3) The directors' report should be more meaningful and should fill up the gap left by the accounting system due to its own limitations.

(4) It is necessary that the shareholders be informed of the pattern of shareholdings and encouraged to participate in management.

(5) Companies managed by managing agents were not far ahead of other companies in the matter of disclosure of facts.

REFERENCES

[1] Para 334 page 130 Report of the Company Law Committee 1962.

[2] In selecting the five techniques, inspiration has been drawn from a similar study by Herman Bevis (a past president of the AICPA) in his work 'Corporate Financial Reporting' and also from the prize winning entries for the 'best presented accounts', awarded by the Institute of Chartered Accountants of India. It can also be noted that almost similar techniques have been suggested as guidelines for assessing the best presented accounts by the Institute of Chartered Accountants of Ceylon (refer—The Accountancy Journal—June 1968).

[3] Regarding the concept of 'materiality' recently, the Council of the Institute of Chartered Accountants in England and Wales had issued a statement which is worthy of note—'Accountancy' August 1968-pp. 180-82.

[4] Jenkins Committee Report-para 122(a)(v)-read with paras 353 to 360

[5] It may be interesting to note here that in Australia the Companies Act (1934-1956) insisted on every company maintaining proper books of account in respect of the assets and liabilities of the company specifying separately all contingent assets and liabilities—"Statutory influence on Accounting in Australia"—by L. A. Braddock at the 8th International Congress of Accountants at New York.