Corporate Disclosure Practices in India – An Analytical Study

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Introduction (abridged)

The Indian Companies Act of 1882 was the first comprehensive piece of legislation related to the disclosure of information in the financial statements. Mainly based on the British Act of 1862, it required compulsory preparation of balance sheet and its audit but preparation of profit and loss account and directors' report etc. were governed by optional regulations which companies were not bound to adopt. The Companies Act of 1913 corrected the situation to some extent and revised the form of balance sheet though some provisions related to the preparation of profit and loss account the directors' report, among others continued to be governed by optional regulations. These were made compulsory by the Companies Amendment Act of 1936 which, by amending many existing provisions and adding new ones, went a long way in improving the law regarding disclosures keeping in view the information needs of the users of financial statements.

The legal framework relating to companies was materially changed between 1882 and 1956. The quantity and quality of information reported in the financial statements underwent major and substantial changes. Notwithstanding major and significant change in the information disclosure requirements, both quantitatively and qualitatively, much was desired to be done yet. Under the companies Amendment Act of 1936, though all companies were required to disclose the amount of gross profits, they were not compelled to report the amounts of sales affected, purchases, selling expenses and many other items. The principles of accounting which should be followed in preparation of financial statements were not laid down, as a result of which the generally accepted accounting principles were not followed, accounting policies were not consistently applied from year to year and no distinction was drawn between capital and revenue items. Also, while preparing balance sheet, items essentially dissimilar in nature were grouped together and not shown separately and bonus shares resulting from the capitalisation of reserves were grouped together with shares issued for consideration other than cash. These were only a few of the many important omissions corrected not until 1956 when the companies act of 1956 was passed.

After the new Companies Act of 1948 came into force in the U.K., it was considered necessary to review the Indian Companies Act also and in 1950 the Government appointed the Bhabha

Committee for this purpose. While recommending the adoption of many provisions of the U.K. Companies Act of 1948 regarding accounts and audit, the Bhabha Committee further suggested the retention of some provisions of the 1936 Act. The Committee also recommended the adoption of several other provisions which it considered necessary in the Indian context and suggested a standard form of balance sheet. The report of the Bhabha Committee paved the way for the Companies Act of 1956.

The part of the companies law relating to financial reporting was again amended in 1960, 1965 and 1969 and 1974 by passing Amendment Acts and in 1961, 1971 and 1973 by issuing Notifications. The various successive changes in the law have required more and more information to be reported in the annual reports of companies.

<u>Appraisal of the current legislation on disclosure of information in the annual reports:</u>

No doubt, the information disclosed in the annual reports of companies today is far more exhaustive and useful than what was being reported before the Companies Act of 1956 came into force. The shortcomings which were experienced after the Companies Amendment Act of 1936 came into force have almost all been removed. The financial statements to be prepared, the accounting principles to be used in their preparation and their contents have been prescribed. The responsibility for their preparation, publication and circulation ahs been vested in the directors and the time and manner of doing all this have also been laid down.

However, there are some significant omissions in the current legislation related to financial reporting. A few areas worth highlighting are the following:

(1) No empirical study has been made in India to find out what exactly are the information needs of people who actually use this information and to what extent these needs are satisfied by the information currently required to be disclosed.

(2) Grouping of some assets and liabilities in balance sheet is such that items which are essentially dissimilar are not shown separately and may in the process give a misleading

impression. For example, short-term component of term loans is not shown under current liabilities. Short-term component is represented by that portion of term loans which is due for repayment within twelve months from the reporting date.

(3) In relation to profit and loss account, there is a wide range of accounting methods available for treatment of items like depreciation and inventories. Companies use different generally accepted accounting without disclosing them in the financial statements. This makes inter-company comparisons much less meaningful.

(4) In addition to the above, there are other aspects of financial reporting which need to be considered. Prominent among them are: Is the qualitative objective of timeliness of information being fulfilled by the current reporting practices? Should diversified companies report more, or different type of, information than other companies? Can one set of standard formats with identical information package subserve the interest and satisfy needs of heterogeneous group of users? The current legislation on disclosure appears to be deficient on these counts. An attempt will be made in this study to probe into these aspects of reporting in India.