Corporate Transparency through Implementation of Indian Accounting standards

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Abstract

Corporate transparency refers to removing barriers to and facilitating of free and easy public access to corporate information. Accounting standards are methodologies and disclosure requirements for the preparation and presentation of financial statements. Accounting standards are usually developed within the institutional and professional framework of a country, and promulgated by regulatory or professional accountancy bodies. Indian Accounting standards issued by Institute of Chartered Accountants of India are being harmonized with internationally recognized set of benchmark standards such as International Accounting Standards or the U.S. GAAP. The study is an empirical investigation on sample of listed companies to determine the extent of compliance with accounting standards leading to transparency in their financial statements. The paper is based on primary survey of Annual reports. Indian Accounting Standards mandatory for the listed companies are compared with disclosures made by the companies. The paper examines whether a significant relationship exists between disclosure in financial reporting and a number of key corporate characteristics like size, profitability, leverage, age of company etc. The collected data is being analyzed with Regression Analysis [OLS].Indian companies have shown high degree of compliance with disclosure requirements of Accounting Standards.

Keywords: Corporate Transparency, Accounting Standards, Disclosures

1. Introduction

Within a few decades, transparency gained a lot of momentum in the corporate word. It has become essential for the long-term survival and success of a business. Corporations have no choice but to make their operations transparent and be open to their stakeholders and also to the entire community. Today, in the globalized corporate world, it is impossible for a firm to escape from the responsibilities of transparency. Transparency can be defined as accessibility of information to the institution's stakeholders regarding matters that affect their interests. Therefore, transparency is needed in all the activities of the organization. Transparency can be categorized as active transparency and forced transparency, based on the firm's attitude towards disclosure. In active transparency, the firm itself takes initiative to make disclosures and uses formal reports such as press releases, annual reports and sustainability reports as a vital link in the chain of active transparency. However, in forced transparency, the media and the stakeholders force the firm to disclose the facts. With increasing globalization, the transparency and trust factors have becomes a cause of concern for every organization. Transparency is the only way to maintain trust among the people related to the organization. Therefore, it can be said that to sustain and achieve high-performance in the knowledge economy, the firm has to develop a trustworthy environment, which in turn originates from transparency.

Accounting standards are formulated with a view to harmonize different accounting policies and practices in use in a country. The objective of accounting standards is, therefore, to reduce the accounting alternatives in the preparation of financial statements within the bounds of rationality, thereby ensuring comparability of financial statements of different enterprises with a view to provide meaningful information to various users of financial statements to enable them to make informed economic decisions. (www.icai.org).

"The stability of our economic system *depends* upon the confidence that user groups have in the fairness and reliability of the financial statements on which they rely. Accounting stands to the quality of the financial statements, make them consistent, comparable and hence useful. Recent years have witnessed the growth of global environmental influences upon business activities of the Multi-national Companies (MNCs). Zealous corporates have been untiring in their hunt for fresh sources of funds. The need to supplement the burgeoning capital needs by international debt and equity is escalating over time. So, the modern focus of accounting has come to serve the capital, markets, to make them more efficient (Carsberg; 1998). This has increased the significance of accounting standards beyond limit.

The Institute of Chartered Accountants of India (ICAI), recognizing the need to harmonise the diverse accounting policies and practices in use in India, constituted the Accounting Standards Board (ASB) on 21st April, 1977. The main function of the ASB is to formulate Accounting Standards so that such standards may be established by the ICAI in India. While formulating the Accounting Standards, the ASB will take into consideration the applicable laws, customs, usages and business environment prevailing in India. The ICAI, being a full-fledged member of the International Federation of Accountants (IFAC), is expected, inter alia, to actively promote the International Accounting Standards Board’s (IASB) pronouncements in the country with a view to facilitate global harmonisation of accounting standards. The Accounting Standards are issued under the authority of the Council of the ICAI. The ASB has also been entrusted with the responsibility of propagating the Accounting Standards and of persuading the concerned parties to adopt them in the preparation and presentation of financial statements. The ASB will provide interpretations and guidance on issues arising from Accounting Standards. The ASB will also review the Accounting Standards at periodical intervals and, if necessary, revise the same.

Studies have demonstrated in a variety of ways, that, (a) differences in financial. Measurement and reporting practices do exist; and (b) these differences do actually create problems of misunderstandings, inefficiencies, and uncertainties to the participants in the global economy (Evans and Taylor, 1986; and Chamisa, 2000). Current multinational trade not only seeks to trade physical goods across borders but also to invest and raise capital internationally. This created a need to communicate the corporation's financial position and future goals to an internationally diversified community of investors and creditors (Murphy, 1999), and led to the enhancement of the significance of accounting standards.

The accounting standards lay down sound accounting policies to ensure proper accounting and to improve comparability of financial statements. They attempt to bring about uniformity in accounting practices by putting reasonable limits on the choice available regarding accounting methods, and disclosure of accounting policies used (Ahuja, 1988, p.1110).

Accounting standards influence the financial statements, which may, in turn, influence the investors' decisions. Further, accounting standards influence the management decisions regarding utilizations of company resources. Accordingly, the real resources of the organization will be affected. Standards thus can have economic implications also (Pasricha, 1989, p. 2(3).

Prior research at the international level has provided evidence that the degree of compliance by the companies claiming to comply with International Accounting Standards (IAS), is very complex and somewhat selective (EI-Gazzar et a/., 1999; Street and Bryant, 2000; Street and Grey, 2002; and Taplin et a/., 2002). These claims and evidences motivated us to examine the degree of compliance of the accounting standards in India. Since, companies in India are obliged to follow the accounting standards issued by ICAI, the present study was undertaken to investigate the extent to which the disclosure requirements of these accounting standards are complied with by the listed companies. Rest of the study has been organized as follows-the objectives of study are listed, literature is reviewed, the explanatory variables affecting disclosure of the requirements of accounting standards by the companies are discussed and the hypotheses which have been tested are specified. This is followed by the details of data collection, measurement of variables, methodology used in study, presentation of the results and finally the conclusion.

2. Objectives of the study

To determine whether a relationship exists between the level of transparency in financial statements and a number of key company characteristics like size, profitability, leverage and age.

3. Review of Literature

Several studies at the international level have addressed the impact of various corporate characteristics on the disclosures in annual report. (Singhvi and Desai, 1971; McNally *et al.*, 1982; Chow and Wong Boren, 1987; Adhikari and Tondkar, 1992; Cooke, 1992; Ahmed and Nicholls, 1993; Meek *et al.*, 1995; Inchausti, 1997; Dumontier and Raffournier, 1998 and Leung, 2005) . Following table represents synoptic view of the empirical studies conducted on disclosures.

Author	**Sample size**	**Independent variable**	**Techniques used**	**Significant variable**
Verma, Garg and Singh 1997	100 India	Size profitability and age	Regression	None
EI-Gazzar *et al.*, 1999	87 cross country	Foreign sale, listing and leverage	Regression and wilcoxon test	All
Murphy 1999	44 switzerland	Foreign sale, listing, audit firm and leverage	MANOVA	Foreign sale, listing
Street and Bryant 2000	82 cross country	Size profitability and listing	ANOVA Regression	Listing US
Joshi and mudhahki 2001	37	Size profitability leverage foreign operations	U test mean SD	size
Street and Grey, 2002	279 cross country	Size profitability listing audit firm multinationality	ANOVA regression	Listing, audit firm
Karim and Ahmed, 2005	188	Size profitability, leverage, audit firm, multinationality, market category	Regression	Size, profitability, leverage, audit firm
Chander S. and Dinesh Kumar, 2007	100	Size profitability, leverage, audit firm, listing age	JB BP test and OLS regression	Size, profitability, leverage, audit firm, listing age

4. Explanatory Variables and Hypotheses

Researchers have addressed the impact of various corporate characteristics on the disclosures in annual report. These characteristics include size, profitability, listing status, type of auditor, size of equity market, leverage, etc. The procedure for operationalizing the variables in the regression analysis and the rationale for expecting them to explain disclosure variability are outlined in the following paragraphs.

4.1 Size

Theoretically, size of a firm is assumed to affect the level of disclosure in the annual reports. Larger the firm, the more is the information disclosed in the annual reports. Many reasons have been advocated in the literature to support this relationship. For example, generating and disseminating information are costly exercises. Only large firms would be having necessary resources and expertise for the production and publication of more sophisticated financial statements with maximum disclosures required by the users. In the prior research, size has been found to be a significant factor in explaining the differences in the extent of disclosure in a number of counties. For example, Singhvi and Desai (1971), Belkaoui and Kahl (1978), McNally *et al.* (1982), Cooke (1992), lnchausti (1997), Dumontier and Raffournier (1998), Joshi and Mudhahki (2001) and Karirn and Ahmed (2005) have found size to be a significant variable in their disclosure studies. However, Ahmed and Nicholls (1994) found both measures of size (assets and sales) to be insignificant in explaining the disclosures by Bangladeshi firms. Also Street and Grey (2002) and Murphy (1999) found it to be statistically insignificant in their studies the independent variables initially considered as measures of size are net assets and net sales.

H 1: Company size is positively associated with the degree of compliance with Disclosure requirements of accounting standards.

4.2. Profitability

Corporate profitability affects the disclosure in annual reports in many ways. Studies on the understandability of financial statements found that narrative disclosures in corporate annual reports are deliberately made complex to communicate bad news and made more lucid and understandable to communicate good news (Adelberg, 1979). Moreover, agency theory suggests that managers of very profitable firms will use external information to their personal advantage. So they will disclose detailed information in order to support the continuance of their positions and compensation agreements. Prior research regarding the association between profitability and level of disclosure is mixed. For example, research by Singhvi and Desai, 1971; Belkaoui and Kahl, 1978; and Wallace et al., 1994, indicate a significant association. Here the variable profitability is used as net profit ratio.

H2: Profitability is associated with extent compliance with disclosures requirements of accounting standards.

4.3. Leverage

A positive relationship can be expected between leverage and disclosure level. Companies having higher levels of debts are seen to be more risky and incur more monitoring costs. The disclosure of information reduces the monitoring costs and facilitates the creditors in assessing the firms risk and cost of debt (Botosan, 1997). EI-Gazzar *et al.*, 1999, Murphy, 1999, Joshi and Mudhahki, 2001 found these variables to be statistically insignificant. The debt equity ratio is used in the present study as measure of leverage and following hypothesis has been formulated.

H 3: leverage is associated with the extent of compliance with disclosure requirements of accounting standards.

4.4 Age

The age of the company may also be associated with the extent of compliance with disclosures requirements of accounting standards. It will provide them matured personnel and standing in the market. However Verma, Garg and Singh 1997 found it to be insignificant in the Indian context.

H 4: age is positively associated with the extent of compliance with disclosure requirements of accounting standards.

5. Data and Methodology

A sample of 30 companies was selected from the companies listed on the BSE. Annual reports of the selected companies were the major sources of data.

5.1 *Construction of compliance index*

Out of 32 accounting standards issued by ICAI, as applicable to the companies as on 31st March 2008, 17 significant accounting standards were selected for the purpose of present study.

AS 1 Disclosures of Accounting Policies

AS 2 Valuation of Inventories

AS 3 Cash Flow Statements

AS 4 Contingencies and Events Occurring After Balance Sheet Date

AS 6 Depreciation Accounting

AS 7 Construction Contracts

AS 9 Revenue Recognition

AS 10 Accounting for Fixed Assets

AS 11 The Effects of Changes in Foreign Exchange Rates

AS 12 Accounting for Government Grants

AS 16 Borrowing Costs

AS 18 Related Party Disclosures

AS 20 Earnings per Share

AS 21 Consolidated Financial Statements

AS 22 Accounting for Taxes on Income

AS 26 Intangible Assets

AS 29 Provisions, Contingent Liabilities and Contingent Assets

On the basis of disclosures requirements of accounting standards a check list was prepared. On the checklist, each item was coded as 1 if disclosed; and 0 if not disclosed and NA if not applicable.

AS Compliance Index was computed for each accounting standard by considering no. of disclosures made by a particular co. divided by total no. of disclosures applicable for each accounting standards.

CI: Simple average of AS Compliance Index for each AS is taken for each company.

5.2 Calculation of explanatory variables

The study uses total of 5 variables. They are market capitalization (MCAP), turnover (TURN), Net Profit Ratio (NPR), Debt-Equity (D/E) ratio and age. Market capitalization and turnover are used as proxies for size. Profitability is measured through NPR and leverage is measured through D/E ratio.

The formulas used are:

Net Profit Ratio (NPR) = Net Profit after Tax / Net Revenue

Debt-Equity (D/E) ratio = External Loans / Total Funds

Debt-Equity (D/E) ratio = Debt / (Debt + Equity)

5.3 Summary Statistics

The summary statistics of dependent as well as independent variables are provided in Table 1.

Table 1 Summary Statistics

Variables	**Market Capitalisation (MCAP) (Rs.crores)**	**Turnover (TURN) (Rs. Crores)**	**Net Profit Ratio (NPR)**	**Debt-Equity ratio (D/E)**	**AGE**	**CI**
Mean	19,425	15,958	0.12556	0.42229	40.22	0.8786
Max	78,010	126,609	0.31007	0.98238	98	1
Min	184	329	0.00550	0	14	0.59375
SD	24954.13697	31644.625	0.07663	0.36810	23.805	0.10749

The table summarizes Mean, Standard deviation, range i.e. maximum and minimum of each variable. It shows the highest level of compliances is 100% whereas lowest is 59.37%

5.4 Formulation of the model

In order to determine the effect of company characteristics on compliance with AS Multiple Regression technique is used. To identify the variable affecting CI step wise regression is used. Two models have been conceptualized as under

MODEL 1

MODEL 1 takes Compliance Index [CI] as dependent variable whereas independent variables are turnover [TURN] as proxy for size, Net Profit Ratio [NPR] as proxy for profitability, Debt equity ratio [DE] as proxy for leverage and AGE.

$$CI = \alpha + \beta_1 TURN + \beta_2\ NPR + \beta 3\ DE + \beta_4\ AGE$$

MODEL 2

MODEL 2 takes Compliance Index [CI] as dependent variable whereas independent variables are Market capitalization [MCAP] as proxy for size, Net Profit Ratio [NPR] as proxy for profitability, Debt equity ratio [DE] as proxy for leverage and AGE.

$$CI = \alpha + \beta_1 MCAP + \beta_2\ NPR + \beta 3\ DE + \beta_4\ AGE$$

5.5 Empirical results

MODEL 1

The OLS [Ordinary Least Square] regression equation for Model 1 gives output which is described in table 2.

Table 2 Regression Output [Model 1]

Dependent variable: CI

R square: 0.272135 Adjusted R square: 0.139796

	Intercept	TURN	NPR	DE	AGE
Coefficients	0.821782	9E-07	0.582283	0.065302	-0.00152
t Stat	9.989318	1.292125	1.790951	0.997458	-1.76859

The above analysis reveals that in Model 1 all the variables, viz., turnover (TURN), Net Profit Ratio (NPR), Debt-Equity (D/E) ratio and age are insignificant at 5% level of significance. However NPR is statistically significant at 10% level. (*t stat* is 1.749058)

MODEL 2

The OLS [Ordinary Least Square] regression equation for Model 1 gives output which is described in table 3.

Table 3 Regression Output [Model 2]

Dependent variable: CI

R square: 0.21822 Adjusted R square: 0.076542

	Intercept	MCAP	NPR	DE	AGE
Coefficients	0.862718	2.05E-07	0.424982	0.038147	-0.0015
t Stat	10.96039	0.220381	1.363937	0.582038	-1.56097

In Model 2 all the variables, viz., MCAP, Net Profit Ratio (NPR), Debt-Equity (D/E) ratio and age are insignificant at 5% level of significance.

The analysis shows that sample companies have shown high degree of compliance with disclosure requirements of Accounting Standards, irrespective of size, profitability, leverage and age. The

Intercept is very high (more than 80%) for both the models. The size of the company represented by the turnover has positive relationship with Compliance Index. (Significant at 10% level). It can be inferred that large sized companies are better adhering to the disclosure requirements.

6. Conclusion

The companies have shown high degree of compliance with disclosure requirements of Accounting Standards, irrespective of size, profitability, leverage and age. The size of the company represented by the turnover has positive relationship with Compliance Index. It can be inferred that large sized companies are better adhering to the disclosure requirements.

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