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A Study on Disclosure in Annual Report of Banks

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Abstract

The essence of accounting is in communication which is termed as disclosure or reporting. Disclosure is the process through which an entity communicates with the outside world. The extent of disclosure adequacy in the annual reports may be a major determinant of the quality of investment decision making in particular and economic resource allocation in general. Banks form a crucial link in a country's financial system and their well-being is imperative for the economy. People by and large deposit their money with banks and the amount of trust they pre-suppose necessitates good disclosure mechanism for banks. The paper applies the Meta-analysis technique. Comprehensive literature review is done for the purpose of cumulating and integrating the findings across studies. The purpose of this paper is to find the research gap and suggest future areas of research in the field of disclosure practices of banks.

Key Words: accounting, disclosure, reporting.

INTRODUCTION

The growth in the size of business enterprise, divorce of ownership and management, increasing public interest in the affairs of the companies and greater emphasis on rational decision making have greatly enhanced the need for and significance of quantitative financial information to the external users (Singh, 1973). The financial and quantitative information generated need to be communicated to the stakeholders in an effective manner and through appropriate medium, ensuring transparency and timeliness. The financial statements act as an important medium of communicating such information to the stakeholders. Preparation of these financial statements is facilitated by a well laid out **syste**m of accounting.

Accounting is often called the language of business. Language helps in forming an opinion about reality and in communication of information. The American Accounting Association defines accounting as the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information. The accounting principle board, 1970 regarded accounting as a service activity and its function is to provide quantitative information, primarily financial in nature, about economic entities, that is intended to be useful in making economic decisions. Thus, the end objective of accounting is to produce and report the quantifiable financial data to the interested groups to be used by them in their respective decisions (Chander, 2005). These interested groups can be internal users, viz., management or external users, viz., shareholders, debenture-holders, financial institutions, security analysts, government, creditors, suppliers and general public. These users want accounting information

communicated to them should be useful so that it helps in rational decision making. Thus, the essence of accounting is in communication which is termed as disclosure or reporting.

Corporate Disclosure: The Concept

Disclosure Defined

Disclosure is the process through which an entity communicates with the outside world (Chandra, 1974). Disclosure refers to the publication of any economic information relating to a business enterprise, quantitative or otherwise, which facilitates the making of investment decisions (Choi, 1973). The American Accounting Association defines it as "the movement of information from private (i.e., inside information) into the public domain." It emerges from these definitions that mean disclosure reporting of quantitative and qualitative information of financial and non-financial nature regarding the reporting, entity to outsiders for the purpose of their decision making. Information about the affairs of the company can be communicated through different media viz. prospectus, financial press releases, annual report, interim reports and personal contacts with company officials. In addition, newspapers, business and industry magazines, investment advisory services and government statistics also provide information about a company. Despite the existence of different sources of information, the annual report is regarded as the most important of information about a company's affairs. Corporate annual reports represent the most easily accessible and extremely important source of basic information concerning an enterprise.

The central focus of corporate financial reporting has changed with the passage of time. In the past, corporate financial reporting was oriented to providing stewardship information, which was essentially backward looking. The essence of stewardship reporting lies in giving an account of what management has done with the money entrusted to it. Today, the preparation and presentation of corporate financial reports is being driven by the consideration of providing information that is useful for making economic decisions, i.e., decision oriented financial reporting. Decision oriented financial reporting is basically concerned with providing information that will enable the users of the financial statements to judge the ability of the company to generate cash flows in the future. This shift in emphasis is fully reflected in the objectives of financial statements developed by Financial Accounting Standards Board (FASB). According to the True Blood Study Group Report', "the basic objective of financial statements is to provide information useful for making economic decisions" (Sorter & Gans, 1974).

Significance of Disclosure

The need for full disclosure is irrefutable in a free enterprise economy (Chandra, 1975). Proper disclosure increases investor confidence and makes financing through the securities market easier (Maloo, 1986).

Sorter & Gans affirm the significance of corporate disclosures when they say that, "Society looks to corporations for assistance in the efficient allocation of resources and expects the corporations to assume the responsibility of providing information that furthers this goal" (Sorter & Gans, 1974). The quality of corporate

disclosures influences to a great extent the quality of investment decisions made by investors (Singhvi & Desai, 1971). There are studies to support the fact that disclosures and access to financial information not only influences the distribution of wealth among the investors but also the allocation of investment among them.

P.B. Miller asserts that quality driven financial reporting will produce a more efficient capital market, a more productive economy and a more prosperous society. Nothing can defeat the unarguable truth that more complete reporting can produce large economic rewards (Miller, 2002). Companies that provide better information on their products to their customers are likely to command a better price in the market (Venkatesh, 1997). Studies further give evidence to the positive relationship between higher disclosure levels and lower cost of capital – be it cost of equity capital (Bostosan, 1997) or cost of debt (Sengupta, 1998).

Investors would prefer to invest in a company that discloses fully than in a company that doesn't. Not only investors benefit from full disclosure, as they do not have to bear the uncertainty caused by the lack of corporate disclosure, but the corporation also gain because an upward move in stock price reduces its cost of capital. Additionally, it improves allocation of capital and productivity in the economy. Another argument in the favour of full disclosure is that it stabilizes the fluctuations in stock prices. Further, lack of adequate disclosure can create ignorance in the securities market and can result in misallocation of resources in the economy.

Disclosure of information has a greater significance in achieving accounting objectives and for this disclosure needs to be adequate. Adequate disclosure means fair and full disclosure so that it helps the users in making rational decisions. Adequate disclosure reflects economic efficiency of the use of resources and thereby helps in directing the flow of capital into productive channels. It would also prevent and mitigate fraud and manipulation. The more the information available, the less is the opportunity for fraud and greater the confidence in the company. Thus, adequate disclosure relates particularly to objectives of relevance, neutrality, completeness and understandability. Information should be presented in a way that facilitates understanding and avoids erroneous implications.

Importance of Disclosure in Banking

It is generally agreed that the most important means of communication with stockholders is the annual report. The extent of disclosure adequacy in the annual reports may be a major determinant of the quality of investment decision making in particular, and economic resource allocation in general. Although these arguments are applicable to all kinds of corporations, they have, thus far, received inadequate attention in the case of financial institutions. It is generally agreed that the reporting practices of banks have not yet reached the same level of adequacy as the non-financial corporations (Kahl & Belkaoui, 1981).

Banks, commercial or developmental are also business entities. They produce and sell financial services instead of products. That is how they are referred to

as financial institutions or financial intermediaries. They perform the middleman function of pooling surplus resources of the saving surplus sector and channelize them to saving deficit sector. The distinct feature about commercial banks, the focus of the present study, is that they are highly leveraged firms. More than 90% of working funds is obtained from deposit liability. For a bank, unlike other companies, which has as its principal obligation the fostering of well being of its shareholders who must be well served, there are far more public than just shareholders who must be well served. If a bank goes into trouble the entire community is affected. They subsist on confidence and the confidence is best demonstrated through the financial solidity. At all time they have to show that there is even not a shadow about their financial standing. This explains why banking legislations all over the world make special provisions for the preparation and presentation of financial statements of banks.

Thus, banks form a crucial link in a country's financial system and their well being is imperative for the economy. In addition, the fact that the people by and large deposit their money with banks and the amount of trust they presuppose necessitates the good disclosure mechanism for banks.

Banks have two related characteristics that inspire a separate analysis of disclosure practices of banks. First, banks are generally more opaque than non-financial firms (i.e., bank activities are less transparent). Second, banks are frequently heavily regulated, because of the importance of banks in the economy, because of the opacity of bank assets and activities and because banks are a ready source of fiscal revenue, thus government imposes an elaborate array of regulations on banks. At the extreme government owns banks. Thus, from the above discussion we can conclude that the study of disclosure practices of banks has a special significance.

RESEARCH METHODOLOGY AND OBJECTIVES

The paper applies the Meta analysis technique. Comprehensive literature review is done for the purpose of cumulating and integrating the findings across studies. The purpose of this paper is to find the research gap and suggest future areas of research in the field of disclosure practices of banks

REVIEW OF LITERATURE

It is a known fact that education is a social activity and no research whatsoever can be conducted in isolation. Every scholar is therefore deeply indebted to his predecessors in the field who have already conducted related studies and brought to light hitherto unrevealed aspects of the subject matter in hand. It is only after reviewing the existing literature on the subject that one can gauge the gap where further research is required or identify the lacunae in previous studies and make an attempt to overcome them by undertaking one's own study.

A brief overview of such studies and research papers is being presented below:

Kahl and Belkaoui (1981) investigated the annual reports of 70 commercial banks from 18 countries during 1975. Disclosure adequacy was measured by the extent to which 30 selected information items were presented in the annual reports.

Differences were found to exist in disclosure adequacy internationally. U.S. banks, it was learned, were leaders in the extent of disclosure. The positive correlation between asset size and extent of disclosure was supported by the evidence in this study. The information items used in the study to measure disclosure adequacy, when classified according to the consensus between producers and users of bank financial statements, indicate ten items of low consensus.

Chipalkatti (2002) in his paper investigated whether enhanced transparency in the case of Indian Banks is indeed rewarded with increased market liquidity. The paper also examined the market's reaction to the enhanced disclosure requirements as required by Reserve Bank of India guidelines. Indian case, enhanced transparency had no significant impact on the market liquidity of private sector banks. In the case of public sector banks, it was observed that enhanced transparency is associated with reduced market liquidity. In addition, no significant change in the market liquidity was observed with the release of the additional disclosure information as required by Reserve Bank of India.

Julia et al (2005) examined the disclosure practices of 30 largest Russian banks. The banks were selected by the size of their total assets as of January 1, 2005. Information included in the three major sources of public information i.e. annual reports, web-based disclosure and statutory filings that were publicly available on the web site of the central bank of Russia had been analyzed for the purpose of study. Disclosure index of 102 items was prepared. An analysis of the timeliness of annual financial reports by Russian banks and existence of board level audit committees was also done in this study. Results showed that the 30 largest Russian banks scored relatively low on transparency, with an average score of 36 percent. Analysis of timeliness of publication of annual reports by these banks indicated that banks published them before or on cutoff date. Only two banks out of the 30 have board-level audit committees. Others either do not have such committees or do not indicate their existence in public reports.

Sahrawat and Davis (2005) investigated the readiness of financial institutions operating within the banking sector in New Zealand for the transition from existing New Zealand financial reporting standards and to ascertain how motivated they were to ensure they had an effective corporate governance regime. Paper also reported on a qualitative investigation of the perceptions of senior management in New Zealand banks on the effects of the revised standards. For these 16 officials from 8 banks agreed to be part of structured interviews. From responses it was concluded that the changes required for convergence to IFRS would be complex but worthwhile exercise. Respondents were aware of the fact that there would be new financial reporting standards that must be adopted but, overall, there was a somewhat alarming lack of awareness of the details on how they would impact the banks' financial reports, it was concluded that the adoption of IFRS s mean high initial costs of transition training, setting up systems and processes which may spin off positive yields in the long term

Singh (2005) made a comparative analysis of financial reporting practices of public

and private sector banking companies in India for 1996-97 to 2001-02. Study is based on 29 public sector and 23 private sector banks. An index of 31 major items, 74 items of directors' report, 27 items in notes to accounts, 16 items disclosed through principal accounting policies, 28 items through charts, graphs and diagrams, 28 items in the performance highlights, 16 items through ratios and 42 items for corporate governance was prepared. Study revealed that most of the public sector and private sector banking companies were disclosing only statutory information. There did not exist a significant difference in the variation of majority of items of financial ratios in both the sectors. Corporate governance disclosure was better in case of public sector banking companies as compared to the private sector banking companies. He suggested that banking companies should incorporate more voluntary information in their annual reports and private sector banks should prepare their annual reports in bi-languidity to reach to the masses.

Huang (2006) assigned a composite bank disclosure index to each of the 180 countries surveyed in the study, yearly since 1994. Using a thick box approach to analyze financial statement of individual banks, the index sought to quantitatively measure the actual disclosure practices of commercial banks around the world, in relation to their assets, liabilities, funding, incomes, and risk profiles. The measurement framework was compatible with IMF's Financial Soundness Indicators (FSI) System, as well as Basel committee prescriptions on bank accounting disclosures. The framework was applicable to banks in low and mid-income countries. Specific policy prescriptions could be made automatically based on the sub-index and sub-component scores linked to individual disclosure categories. The report also utilized the time-series and cross-sectional variations of the index to conduct a series of assessment and diagnosis on several systematically important developing countries and regions, as examples to demonstrate the index's policy applications.

Singh Kashmir (2007) in his article focused on the financial reporting norms for banks. He classified the reporting norms into two categories – statutory reporting and non-statutory reporting. He concluded that most of the banks are disclosing only the statutory items in their annual reports. He further identified the gap in the compliance of accounting standard of segment reporting, EPS, Related Party Disclosure, Assets on lease and differed tax liability, etc. He suggested that ICAI should bring an accounting standard suitable to Indian conditions with the help of RBI.

Singh Kashmir (2007) examined empirically the non-mandatory disclosure practices of banking companies in India, both item-wise and bank-wise for the year 2004-05. An index of disclosure of 21 reporting items was constructed and the annual reports of 40 banking companies of the public and private sectors were analyzed to check the level of disclosure of non-mandatory reporting items. The results of the study showed that the level of reporting of non-mandatory items was very low and wide variation in disclosure score existed among various banking companies of public and private sector. However, the banking companies of both the sectors show a great deal of similarity

in respect of reporting non-mandatory information among them.

Hossain (2008) examined the extent of mandatory and voluntary disclosure by listed banking companies in India. An index of 184 items consisting of 101 mandatory and 83 voluntary items was constructed. Results showed that average score for mandatory items were 88 and for voluntary items were 25 only. The association between company specific characteristics and total disclosure of the sample companies was also analyzed. Results stated that size, profitability, board composition and market discipline variables were significant and other variables such as age, complexity of business and assets in place were insignificant in explaining the level of disclosure. Results of the study also showed that Indian banks were very compliant with the rules regarding mandatory disclosure, but they were far behind in disclosing voluntary items.

Cayanan (2009) focused on the financial reporting practices of some listed Philippine banks in 2008, after the Philippines fully adopted the international accounting and financial reporting standards in 2005. The 2008 annual reports of 8 banks were assessed in terms of their compliance with Generally Accepted Accounting Principles. The annual reports of 16 banks were assessed for the year 2003. At the end it was concluded that significant improvement in the reporting of major balance sheet accounts such as loan receivable, other financial assets, and financial liabilities have been observed in the 2008 financial statements of banks, the financial reporting practices of banks still leave much to be desired, especially in areas of consolidating subsidiaries and special purpose vehicles and segment information.

Jaydev, Monga and Tiwari (2010) examined the disclosures made by the banks across the globe to find out where India stands in terms of disclosures in the banking industry and also seeks to find out how the disclosures, as and when mandated in India have impacted the share prices of various banks. Annual reports of 9 banks from various parts of the world were studied and the information contained therein was used as proxy for information disclosure regulatory requirements the banks have to follow in their respective countries. It was concluded that Indian banks are lagging behind their counterparts in other developing countries. Event study method was used to find out the impact of RBI policy announcements on the shareholder wealth in the Indian banking industry. It was found out that new disclosures mandated by RBI do not have any significant impact on the share prices of banks.

Hasan (2014) measured the impact of firm size on the level of non mandatory disclosure in the annual reports of listed banks in Bangladesh. The study is based on the annual reports of 15 listed banks of 2011. A disclosure checklist with 58 items has been used to measure the extent of non mandatory disclosure. The study mainly applied regression analysis to assess the relationship. The findings indicate that size of a firm is a significant factor in explaining the level of non mandatory disclosure in the annual reports.

Mamun and Kamardin (2014) explored the corporate voluntary disclosure practices of the listed banks in an emerging economy namely Bangladesh.

Results show that the extent of voluntary disclosure significantly improves from 2005 to 2008. However, the level of disclosure items related to corporate governance and risk management are lower than other disclosure categories. Overall findings of this study contribute in the accounting and economic literature by adding an empirical result of voluntary disclosure of a highly regulated industry from an emerging economy. Nevertheless, the results have the limitation to generalize for other industries as well as for banks from countries.

Hawashe (2015) investigated empirically whether there is any significant association between seven commercial bank-specific attributes (i.e. age of bank, size of bank, bank liquidity position, profitability, government ownership, foreign ownership, and listing status) and the extent of voluntary disclosure in the annual reports. Ordinary Least Squares (OLS) regression model is used to test the association between bank attributes and voluntary disclosure. The results of regression analysis indicate that banks size and listing status are significantly associated with the level of voluntary information disclosures. The findings also revealed the extent of voluntary disclosure in annual reports is not significantly influenced by other bank's attributes. The current empirical study contributes to that investigation in the context of banking companies and provides new insight into determinants of voluntary disclosure in the annual reports of listed and unlisted commercial banks.

Hawashe (2016) measured the level of voluntary information disclosure in 54 annual reports of listed and unlisted Libyan's commercial banks, over a six-year reporting period (2006-2011). It also examines if there has been any significant improvement in the levels of voluntary information disclosure provided in the annual reports, using a longitudinal analysis approach. To measure the voluntary disclosure level, this study develops a scoring sheet comprised of 63 voluntary information items and a dichotomous scoring method was applied. A longitudinal analysis shows that the extent of all five types of information disclosures is low, with an average of 38%, however there was an improvement in the general level of voluntary disclosure and its categories over a six-year period. In addition, it shows that the level of background information is the highest level of voluntary disclosures over the periods of the study and the level of corporate social information is the lowest level of voluntary disclosure in the annual reports of the study time periods. This research project is to help develop the existing disclosure literature in relation to the banking sector, which is currently sparse due to the limited empirical research studies on the extent of banking disclosure and its developments.

CONCLUSION AND SUGGESTIONS

The disclosure literature in relation to banking sector is sparse due to the limited empirical research studies on the extent of banking disclosure. The literature on disclosures in banking investigates a wide range of issues: such as banking disclosure practices looking at mandatory or voluntary items or both, determinants of voluntary and mandatory disclosure and the economic consequences of disclosure. Studies also investigate into disclosure practices of public sector banks and private sector banks. Studies also investigate the impact of corporate attributes like age,

size, ownership, profitability and management on the extent of disclosures. After reviewing the literature, it is suggested that further research can be undertaken to investigate the extent of disclosure published in quarterly reports or on the level of information provided through commercial banks websites. A study can also be undertaken to critically review the different techniques used to measure disclosures. It will provide future researchers to identify exemplars and to select suitable techniques or to develop their own techniques. Last but not the least study can also be undertaken to study the impact of disclosure on cost of capital, earnings quality and share prices etc.

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