

THE QUALITY OF DISCLOSURE IN THE ANNUAL REPORTS: EVIDENCE FROM AN EMERGING MARKET

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Abstract

This paper aims at determining the quality of disclosure in the annual reports of the listed companies in the Dhaka Stock Exchange Ltd. by applying the Singhvi and Desai (1971) index over the twenty seven selected companies of the "Food and Allied" and "Engineering" sector. The twenty-seven companies use the index to describe the trend of reporting practices for the years 2007 and 2008. We find that most of the companies are very much consistent in their disclosure practice. But a very few companies tried to enhance the quality of disclosure over the years.

Keywords: Quality of disclosure, Singhvi and Desai index

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Introduction

Quality of disclosure in the annual reports is one of the most discussed and central issues both in theoretical and empirical research. Over the years numerous theories have been put forward to address the issues and empirical studies have been conducted on different financial environment most of which focused on developed countries.

The main objective of this study is to evaluate the quality of disclosure from the annual reports of the companies listed in the Dhaka Stock Exchange Ltd as per the Singhvi and Desai (1971) index. Singhvi and Desai Index refer to the quality of the disclosure for every annual report was measured by the total weight that could be assigned to the report as per the index. Weights were assigned to the items in order to note distinction in their relative importance. Total weights given to all items equal 68. The index used by Singhvi and Deasi (1971) has been used to calculate the quality of disclosure score of each annual report and then a ranking is made as per the assigned score to each annual report. It is widely accepted that the more the disclosure of the financial and non-financial information the better the quality of the reporting. Hence, the accountants try to disclose maximum information at a minimum content - thus providing maximum informational benefit to the users and minimizing the cost of providing information. But minimizing the cost does not indicate the compromise with the quality and so the endeavor of the accountants is to maintain the optimum quality of disclosure - providing sufficient information in the annual report at a minimum

possible cost. An additional objective is to identify the factors needed to be considered for the purpose of evaluating the quality of disclosure in the context of Bangladesh.

By investigating the quality of disclosure from the annual reports of the companies as per the Singhvi and Desai (1971) index utilizing 27 firms listed in the Dhaka Stock Exchange Ltd. We find that most of the companies are very much consistent in their disclosure practice. But a very few companies tried to enhance the quality of disclosure over the years. By itself, our study extends and complements the current literature that examines the quality of disclosure from the annual reports of the companies as per the Singhvi and Desai (1971) index.

The rest of the paper is organized as follows. Section 2 begins with a theoretical framework and previous studies. Section 3 describes the research methods and justification of the methods. Section 4 presents our empirical results. Section 5 provides the conclusion.

Theoretical framework and previous studies

Moonitz (1961) emphasized mainly on three facets - (a) what should be disclosed, (b) to whom and (c) how disclosure should be made. His discussion of disclosure is finally summarized as postulate C-5. This postulate emphasizes mainly on the fairness of the disclosure such as not to mislead the users of the financial report. The implication of the definition given by Moonitz (1961) with respect to adequate disclosure can be determined by

seeking answers to the following five interrelated questions:

(a) For whom the information is to be disclosed?

Information should be disclosed mainly for the present and potential users like owners, other investors, creditors, employees, financial analysts, government, and labor union and so on having direct or indirect interest in the organization.

(b) What is the purpose of the information?

It is necessary to disclose only the relevant information as irrelevant information do not help at all in the decision making process. But the purpose of the information should be determined first before the determination of the relevance of specific type of information. Information, which is relevant for one purpose, is not necessarily relevant for another purpose. Different types of user groups have different purposes and the disclosure should be made effective after incorporating the information such that everybody's purpose is fulfilled.

(c) How much information should be disclosed?

Information should be disclosed as much as possible but in a concise form. Only relevant information, both financial and non-financial, should be disclosed as per the demand of the users for an adequate disclosure. In case of mandatory items of disclosure (as required by different rules and regulations) the content and relevancy of the information is uncontrollable. But in case of voluntary items, the disclosure of information can be controlled as per the relevancy of the information.

(d) How should the information be disclosed?

Understandability of the target audience is one of the key-factor for the quality of disclosure. Information should be presented in a grouped and logical manner such that every user can easily identify his own required information for decision-making and easily understands its implication. Textual material, including captions, footnotes etc. should be readable by the target audience. Information, which deserves additional emphasis, should be disclosed with special care so that they are not buried in a location, which could easily be overlooked.

(e) When should the information be disclosed?

Timeliness is another key-factor to ensure the effectiveness of the disclosure. An implicit assumption in timeliness is that, the speed with which the information is disclosed is balanced against the necessary levels of accuracy and completeness as a time barred information can never help in the decision making process. Financial information should be communicated early enough to be used effectively for economic decision-making.

Various international bodies like IASB, AICPA, and FASB etc. have provided with various guidelines to disclose information. In Bangladesh, ICMA and ICAB are the governing bodies of accounting profession, who adopt the guidelines for disclosure provided by various international bodies from time to time. Besides all these guidelines, several acts and laws relating to the disclosure in periodical reports are in-force. In Bangladesh some of these laws are The Banking Companies Act - 1991, The Insurance Act - 1938, The Companies Act - 1994 and The Securities and Exchange Commission Rules - 1987. All these laws and guidelines are to ensure the availability of

financial information to the users. In this study, an attempt has been made to measure the quality of disclosure in the annual reports of the listed companies in the Dhaka Stock Exchange Ltd by using Singhvi and Deasi Index.

For measuring the quality of disclosure, different researchers have followed different procedures. Cooke (1989) used a scoring method to determine the disclosure score by using a dichotomous procedure in which an item scores one if it is disclosed and zero if it is not disclosed. The total disclosure index is the ratio of the actual scores awarded to a company to the scores, which that company is expected to earn. For disclosure purpose, he took 224 items of the annual reports by making no distinction of mandatory and voluntary items. The same procedure has been followed by Abayo et al. (1993) by considering both 88 mandatory items and 44 voluntary items, Parry and Groves (1990) where they mainly concentrated on the extent of disclosure and the timeliness of reporting - plus a new variable, the type of audit report received.

Wallace (1988) also used the same procedure to develop the disclosure index for annual reports but he developed two types of disclosure indices. Based on 120 mandatory items and 65 voluntary items (total 185 items), he constructed both unweighted index which is the ratio of the number of items a company disclosed divided by the total that it could have disclosed and six weighted disclosure indices reflecting the preferences of the different user groups (Accountants, Financial Analysts, Top Civil Servants, Other professionals, Managers and Investors).

A little different procedure has been followed by Firth (1979) where he selected 48 items of annual reports and sent them to different financial analysts to rank them by their importance in annual reports by using a 5-point scale (1-5) where score '5' meant the item was very important and score '1' meant unimportant. The weighted score of each item was then calculated (the highest weighted score indicated the highest importance) and the disclosure index was developed by assigning the weighted score of one item to the report of the company if the item was disclosed in the report and zero if the item was not disclosed, which is to a large extent similar to Cooke (1989). Chow and Wong-Boren (1987) also followed the same procedure to develop both weighted and unweighted disclosure score by using a 7-point scale for 24 voluntary items of annual reports.

In the method adopted by Cooke (1989), Abayo et al. (1993), Parry and Groves (1990), there is no mention in the corporate annual report of disclosure items. It is concluded there that these items of disclosure were not relevant to that company in that year. That might result in the non-penalization in case of any annual report for nondisclosure of information that could have been relevant to it. In other studies like Wallace (1988), Firth (1979), Chow and Wong-Boren (1987), the main problem was that the importance was given upon the perceptions of financial analysts. Financial analysts, as a group, may focus most of their attention on the relatively large and prominent firms, thus, their perception would probably be biased to these groups.

In case of the Barrett Index (1977), variables like the influence of the CPA firms and the corporation's earning margin were not included. This index includes only 17 items, which are unusual or uncommon relating to different companies. The argument was, the study (Barrett, 1977) only selected the voluntary items, which were not made mandatory by the law. He also excluded common items like net income as every annual report contains this information.

Specification of the model

Cerf (1961) followed a different procedure where he selected 31 items of annual reports on the basis of a study of the investment decision process, a review of the literature on how the decision should be made, interviews with security analysts, and an examination of analysts' reports. Weights were assigned to the items in order to note distinctions in their relative importance. The items included in the index were classified into four categories and were given different weights ranging from 1 to 4 to indicate the importance of different information. The quality of the disclosure for every annual report was measured by the total weight that could be assigned to the report as per the index.

The same procedure has been followed by Singhvi and Desai (1971) but they made a little change in the Cerf index. By excluding three items of the Cerf index (which were more relevant to wasting asset corporations) they included additional six items (with weights) on the basis of the need for these items expressed by several writers like Bradish (1965) and Anderson (1962) and some other experts. Buzby (1974) also the same procedure where for developing the disclosure index for small and medium size companies, he selected a total of 38 items of annual reports, which were sent to different financial analysts to

rank the items by using a 5-point scale (0-4) with a '0' being assigned if it was not necessary for the item to appear in the annual report. A '4' was to be assigned if it was essential that the item appear in the annual report. Barrett (1977) also followed the same procedure where he selected 17 items of annual reports with different weights for each item for the development of the index.

The method used by Cerf (1961) failed to incorporate some relevant variables like "the influence of the CPA firm" and "the corporation's earning margin" (Singhvi and Desai, 1971). This study includes disclosure items of wasting asset companies. This type of company is not available in Bangladesh. So, these items make the index unsuitable for calculating the disclosure score of any company of Bangladesh.

While Singhvi and Desai (1971), the items relating to wasting asset companies of Barrette index are excluded from the index. Again six additional items were included which are very much relevant in the context of Bangladesh. The total weight of this (Total weight = 68) is higher than some other indices like the Barrett index, which totaled 56.50. After a consideration of the relative advantages and disadvantages of several alternative measurement systems, we have chosen an approach similar to the one used by Singhvi and Desai (1971). The index used by Singhvi and Desai (1971) has been used to calculate the quality of disclosure score of each annual report and then a ranking is made as per the assigned score to each annual report.

For this study, a total of twenty-seven companies listed in the Dhaka Stock Exchange Ltd. were selected (fourteen from the "Food and Allied" sector and thirteen from the "Engineering" sector) as sample. Two annual reports of these companies were collected for consecutive years to test the consistency in the reporting system. The companies are as under:

Amam Sea Food Company Ltd.	Eastland Cammellia Co. Ltd.
Apex Food Company Ltd.	Eastern Cables Ltd.
Agricultural Marketing Company Ltd.	National Tea Company Ltd.
Alfa Tobacco Manufacturing Company Ltd.	Meghna Vegetable Oil Company Ltd.
Anwar Galvanizing Ltd.	Singer Bangladesh Ltd.
Aziz Pipes Ltd	Renwick, Jajneswar & Co. (BD) Ltd.
Aftab Automobiles Ltd.	National Tubes Ltd.
Bangladesh Leaf Tobacco company Ltd.	Zeal – Bangla Sugar Mills Ltd.
Bangladesh Plantation Ltd	Quasem Drycells Ltd.
British American Tobacco Company Ltd	Olympic Industries Ltd.
Bengal Biscuit Company Ltd.	Monno Jute Stafflers Ltd.
Beximco Fisheries Ltd.	Monno Jutex Industries Ltd.
Bangladesh Lamps Ltd.	Karim Pipe Mills Ltd.
Hill Plantation Ltd.	

Findings of the study

From the Table -1, it is observed that in the sample annual reports of the "Food and Allied" sector's companies, the Agricultural Marketing Company Ltd. has disclosed in the most efficient manner (with a disclosure score of 48) in 2007. In 2008, two companies' annual report - the

Agricultural Marketing Company Ltd. and the Alfa Tobacco Manufacturing Company Ltd. scored the highest (50). In most of the positions in the ranking, it is observed that the disclosure score has elevated in 2007 from 2008. It indicates a positive trend in the disclosure practice by the companies under the "Food and Allied" sector.

Table 1

Disclosure index of "Food and Allied" sector with ranking as per Singhvi and Desai (1971) index score

Name of the company	Total weight (out of 68)			
	Year-1	Rank	Year-2	Rank
British American Tobacco Company Ltd.	44	3	43	6
Amam Sea Food Company Ltd.	45	2	46	3
Apex Food Company Ltd.	43	4	44	5
Eastland Camellia Company Ltd.	37	7	37	7
Bengal Biscuit Company Ltd.	40	6	45	4
National Tea Company Ltd.	44	3	44	5
Meghna Vegetable Oil Company Ltd.	44	3	44	5
Beximco Fisheries Ltd.	40	6	43	6
Agricultural Marketing Company Ltd.	48	1	50	1

* Year - 1 indicates the financial year of 2007 or 2006-2007 and Year - 2 indicates the financial year 2008 or 2007-2008.

From the table - 2, again we can observe that in the sample annual reports of the "Engineering" sector's companies, the Aziz Pipes Ltd. has disclosed in the most efficient manner in both the years of 2007 and 2008 (with a consistent disclosure score of 55). Again, the Olympic Industries Ltd. scored second highest in the disclosure score (52) both in 2007 and 2008. It reveals that, although these two companies are very much consistent in quality reporting, but they did not have any effort to enhance the

quality of reporting. In most of the other companies, the disclosure score was almost the same in both the years.

There is some information which has been disclosed by all the companies, while some other information was not disclosed by either of the companies. These are mentioned here-

Table 2

Disclosure index of "Engineering" sector with ranking as per Singhvi and Desai (1971) index score

Name of the company.	Total weight (out of 68)			
	Year-1	Rank	Year-2	Rank
Singer Bangladesh Ltd.	49	3	49	4
Aftab Automobiles Ltd.	43	7	49	4
Aziz Pipes Ltd.	55	1	55	1
Renwick, Jeanswear & Co. Ltd.	36	10	37	8
National Tubes Ltd.	45	6	45	7
Eastern Cables limited	46	5	50	3
Karim Pipe Mills Ltd.	39	9	37	8
Monno Jutex Industries Ltd.	49	3	48	5
Monno Jute Stafflers Ltd.	49	3	49	4
Bangladesh Lamps Ltd.	47	4	46	6
Olympic Industries Ltd.	52	2	52	2
Quasem Drycells Ltd.	41	8	50	3
Anwar Galvanizing Ltd.	7	11	37	8

*Year - 1 indicates the financial year of 2007 or 2006-2007 and Year - 2 indicates the financial year 2008 or 2007-2008.

(a) Items of information disclosed by all of the Companies

The items, which are disclosed by all of the companies, are as follows: Comparative Income statement - 2 years; Comparative Balance sheets - 2

years; Statement of reconciliation of earned surplus; Source and application of funds or cash flow statement; Method of inventory valuation; Basis of inventory valuation; Method of depreciation; Capital expenditure amount - current year; Statement of gross and net

property account; Information on labor contracts; Details in respect to out standing stock issues; List of name of directors; Inventory breakdown.

(b) Items of information disclosed by none of the companies

The items of information that are disclosed by none of the companies are stated bellow: Description of Principal Plants; Index of Selling Prices; Index of Raw Material Prices; Discussion of Industry Trends.

Conclusions

Consistency in the disclosure practice in the annual report is highly appreciable as it helps the users to compare the information in different ways and take their decisions. We find that most of the companies are very much consistent in their disclosure practice. But a very few companies tried to enhance the quality of disclosure over the years. This does not indicate a good sign as there is a huge scope left to improve the quality of disclosure for every company. The more they will try to disclose more relevant information the more the quality of disclosure will improve. Which is the fundamental requirement of the users to take economic decisions?

Besides the items of information of the index selected, there are a lot of items of information, which can also be incorporated in the disclosure index while evaluating the quality of disclosure in the context of Bangladesh. These items may be as follows: Nature of Business Activities; Value Added Statement; Earnings per Share; Prevailing Market Price of Shares Production Capacity; Payments/ perquisites to the Directors/officers; Audit Fees; Remittances of Foreign Currency; Transaction of Foreign Currencies

All these items of information will enhance the Index and will also make the evaluation more fruitful. By this way the satisfaction of the investors and other users of the information can be ensured.

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