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Do compositions of board and audit committee improve financial disclosures?

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Structured Abstract

Purpose: The study examines the impact of corporate governance practices on the level of financial disclosures made by the Indian firms. This assumes importance in the context of the role of financial disclosures in addressing the agency problem.

Design/methodology/approach: Financial disclosure score is computed by considering disclosures provided by the generally accepted accounting principles and is our dependent variable. Our independent variable - corporate governance score is an index comprising of external governance mechanisms. We empirically examine the impact of corporate governance practices on financial disclosure using multiple regression model for 200 large listed Indian firms.

Findings: The study suggests that quality of governance practices significantly improves financial disclosure practices of the firm. Particularly, the composition of audit committee is effective in improving disclosures.

Research/ Practical implications: The finding has implications for policy makers and practitioners. It will help investors, lenders and other stakeholders to assess firms' financial disclosure quality. In addition, the findings, suggest the influence of governance practices on disclosure, might help in the formulation of appropriate policies about board structure and audit function. It is also a call to investors to emphasize on governance quality of the investing firms.

Originality/value: The study builds a case for an urgent intervention for improvising the existing governance standards to improve the quality of financial disclosure in an emerging market context.

Keywords: Corporate Governance, Financial Disclosure, Financial Reporting, Disclosure Index, Corporate Governance Index

Article Classification: Research Paper

1 Introduction

Anecdotal evidence from the popular press pointed at the quantum of loss in excess of $2 billon by Indian investors. These investors lost money predominantly from corporate frauds and bad governance from the year 2003-08 (Kriplani, 2009). Incidentally, the year 2009 witnessed the biggest corporate fraud in India amounting to $1.47 billion by one of the India's largest and most respected software and IT services firm "Satyam" (Rajagopalan and Zhang, 2009). The incident aroused the analyst sentiment, and leading investment houses published reports on the unsatisfactory disclosure standards. Hardly four firms complied with the highly desirable disclosure standards out of the 68 well-known firms with the significant global presence (Kriplani, 2009). The increasing nature of these financial frauds compelled the investors to demand transparency and professionalism in the management of the firm's business. Thus, there was an emphasis on developing codes of corporate governance to prevent such crisis/ failures in future.

Although financial reporting standards advanced around the world, transparency and reliability remain unrealized. This can be explained by the slow progress of underlying institutional and economic factors (Holthausen, 2009). In particular, the lack of transparent and reliable financial reporting is a global phenomenon, whose need enhanced exponentially due to the growing corporate frauds. These accounting and stock market frauds (like Enron, WorldCom, Satyam for instance) are symptomatic of the deficiencies in transparency, financial reporting, and corporate governance (Vishwanath and Kauffman, 2001). These frequent scandals call for improvising the existing financial reporting practices and information disclosure environment (Lang and Lundholm, 2000). Increasingly regulators from several countries have acted upon these calls to protect the investors' interest and thereby enhance the confidence in the capital market (Leuz *et al.,* 2003). The aftermath of Enron's of the world led to the adoption of governance codes. These codes strengthened the accounting, auditing procedures, and public oversight with enhanced civil and criminal penalties for the violations. This regulation to enhance the efficacy of the corporate governance systems was a step to protect shareholders against the opportunistic behavior of managers (Khanna and Palepu, 2004).

These widespread community concerns regarding the inadequacy of corporate governance standards expressed since the Enron debacle are not limited to developed countries, rather an industry body (Confederation of Indian Industries, CII) initiated these reforms in India (a developing country). Later, these codes were recommended by Securities and Exchange Board of India (SEBI, similar to SEC in the USA) to enhance investor protection. Recently, the introduction of the Indian Companies Act 2013 brought progressive and transparent processes to enhance value for the stakeholders, directors, and management of companies (e.g. codification of duties of directors, appointment of women director, quantum, and qualification of independent director). Institute of Chartered Accountants of India (ICAI) prescribes disclosures, especially financial disclosures. Here, ICAI recommended several Accounting Standards (AS)/Generally Accepted Accounting Principles (GAAP) to assist in the preparation of the financial statements. The disclosure quality might be impacted based on the level of governance practices of the firm. This calls for an in depth investigation of the impact of effective corporate governance mechanism on the financial disclosures. The introduction of these governance mechanisms and firm's response (in terms of adopting enhanced disclosure practices) has brought about a new dimension for accounting research. While there are several facets of corporate governance that are addressed by the literature, our study extends the literature towards a not so well researched area. The study would be rewarding for investors, stakeholders and importantly regulators, who could understand the impact of existing regulatory environment.

Agency theory is the predominant theoretical lens adopted by the extant literature on the influence of disclosure on firm's corporate governance. Typically, characterized by the principle-agent agency problem (La Porta *et al.,* 2000), the theory suggests that companies increase disclosure in order to minimize conflicts between principal (shareholder) and agent (manager). Improved disclosure reduces the gap between management and the outsiders (Healy and Palepu, 2001), enhances the value of stock in the capital market (Haggard *et al.,* 2008), increases liquidity, (Diamond and Verrecchia, 1991) and finally reduces the cost of capital (Apostolos and Konstantinos, 2009; Karim, 1996; McKinnon and Dalimunthe, 1993). However, emerging markets (like India) are characterized by family owned businesses or family managed firms leading to concentrated shareholding by the family. Here the agency problem is principle-principle conflict (i.e.) majority shareholders (controlling families) expropriating minority shareholders. Here, firms might self-select accounting policies to serve their own interest. These firms are usually characterized by pyramiding and tunneling utilizing complicated crossholdings with separation of cash flow and control rights (Scott, 2014). This agency problem between controlling families and minority shareholders can further incentivize firms to engage in practices such as earnings management. Extant theories of governance (see for e.g. Stakeholder theory, agency theory, legitimacy theory, and political economy theory) also emphasize on disclosures by firms (Choi, 1973). Thus, the theoretical framework helps us to understand the importance of the role of disclosures in corporate governance.

The study contributes to the existing literature in several ways. First, our empirical analysis emphasizes the need for better governance practices to improvise the quality of financial disclosure practices. India's governance practices are plagued with myriad problems of economic uncertainties, weak legal controls, investor protection, and frequent government intervention. The poor score of 38 (corruption perception index score out of 100) indicates a general weak or ineffective leadership to tackle corruption. In addition, the slack judicial process with scarce resources (14 judges for every million people) accentuates the existing governance problems, leading to a backlog of 31 million cases in the courts (estimated to take 320 years to clear). These harsh realities create a situation, which threatens the sustainability of the economy (Transparency International, 2015) and hence need urgent intervention for improvising the existing governance standards to improve the quality of financial disclosure.

Second, several studies have focused on effective corporate governance mechanism through board monitoring and independence and its association with financial performance (see for example Coles *et al.,* 2001; Erhardt *et al.,* 2003; Bhagat and Bolton, 2008; Jackling and Johl, 2009). However, there is limited evidence on the impact of corporate governance on disclosure policy at the firm level. Thus, our study provides little evidence on the same.

Third, extant literature draws on implications derived from studies focused on developed markets. However, emerging markets with an institutional framework widely divergent from their western counterparts demand the exposition with evidence from indigenous works. Among emerging markets, India is the world's second most populous country. The country boasts of having 5% of the middle class population today and expects to be the world's largest middle class consumer market by 2030 surpassing China and US (World Bank, 2015). Thus, this third largest economy in in GDP terms (adjusted for international price differences) provides an interesting landscape to study (World Bank, 2015) the governance practices impact on financial disclosure.

Fourth, the literature primarily focusses on widely held firms, particularly in the US. Given that, the institutional framework (e.g. ownership structure, governance environment, firm characteristics) is distinctly different from those of developed market, the findings of earlier studies may not apply in the context of emerging market firms. However, in India, implementation of governance regulation is comparatively weaker as compared to those in the developed markets like the United States (Narayanaswamy et al., 2012). Further, majority firms are affiliated to business groups and are being run by the family members of the founders. Hence, controlling shareholders are likely to have a lot of say in the decision-making within the firm. Thus, India provides an ideal setting for analyzing this question as governance practices are still in infancy and evolving.

Fifth, the Indian context provides an interesting setting as unlike the developed market, we lack uniformity of regulations among accounting standards, financial disclosures, and corporate governance. Further, there is a dichotomy between the objectives of both the regulators. While, ICAI suggest regulations for disclosures and compliance with accounting standards; SEBI promotes regulations on compliance with better corporate governance practices. Thus, the study provides evidence on alignment of objectives of both the regulators namely SEBI and ICAI and further contends that both the regulators aim at investor protection at large.

Finally, prior studies on the impact of governance on disclosure considered a limited worldview of disclosure. There disclosure was limited to either voluntary disclosures or specific financial statement disclosure (Charles and Jaggi, 2000; Forker, 1992; Ghazali, 2008). Whereas the present study draws inferences from an exhaustive list of disclosures which are proposed by Indian Accounting Standards to determine the level of disclosure for each firm.

The paper is organized in the following manner. Section two discusses the related literature and lay down the hypothesis of the study. The research design is discussed in section three followed by the results in section four. Finally, the concluding remarks are presented in section five.

2 Literature review and hypothesis development

Effective corporate governance mechanism is designed to facilitate the monitoring role of directors (Jensen,1986). Board structure and quality is always crucial for the firm to generate adequate and reliable information for the stakeholders. Adequate size of the board provides better supervision and high quality corporate decisions (Pearce and Zhara, 1992). Similarly, the inclusion of independent directors on the board also improves financial reporting behaviour of the firms and improves the quality of disclsoures. Fama and Jensen (1983) and Leftwich *et al.,* (1981) suggest that independent directors in the board are effective in controlling mangers expropriation and improving disclosures. Menon and Williams (1994), Adams (2003) and Lara *et al.,* (2009) reports that board effcetiveness improves with discussion and number of meetings. Multiple directorships are viewed in the literature from both the angles. On the one hand, it may signal expertise in bringing different exposure to the board and may bring networking and resource benefits (Pfeffer, 1972). Contrastingly, Lipton *et al.,* (1992) argued that it might compromise on commitment. In addition, Beasley (1996) documents about the relation between multiple directorships and financial statement fraud. Forker (1992) studies the relationship between corporate governance and disclosure quality and report a negative relationship. Fama and Jensen (1983) suggests that CEO duality signals the absence of separation of decision management and control echoed this finding; hence firm might suffer in the struggle for existence in the end. Sears, Westinghouse, General Motors, and IBM are testimonials to the adverse impacts of CEO duality on poor performance (White and Ingrassia, 1992).

Audit committee is one of the key constituent of effective governance specifically when it comes to financial disclosure and transparency. It is the most powerful and well-established board committee, which acts as a deterrent to financial improprieties and frauds. It enables the board to keep a track of the financial health of the firm (Varma, 1997).The effectiveness of corporate audit committee in overseeing the financial reporting process depends on the independence of audit committee members (Klein, 2002), and the expertise of audit committee members (Dhaliwal *et al.,* 2010). They also improve the monitoring role of the board by providing expert knowledge and understanding of the financial statements of the firm (Pincus *et al.,* 1989). DeFond and Jiambalvo (1994) suggest that the existence of audit committee brings down the accounting errors of overstatement. Audit committees with more number of independent and active members bring down other accounting irregularities (Dechow *et al.,* 1996; McMullen and Raghunandan, 1996; Abbott and Parker, 2000; Peasnell *et al.,* 2005).

Lately, Fathi (2013) examined the relationship between the level of disclosure and its determinants. Specifically, relating to corporate governance mechanisms for a sample of non-financial listed Tunisian companies and suggest that the level of disclosure is explained by the size, leverage, profitability, duality, concentration of ownership and control quality as measured by the number of auditors and the presence of Big 4.

Board of Directors is entrusted with the responsibility to ensure the effective functioning of the company. Regulatory authorities across the globe ensure effective governance through the optimum composition of the board. In India, SEBI provides for majority independent directors, restricts outside directorship, and encourages adequate participation through mandatory attendance by the board members. Such provisions are aimed at bringing more accountability to the shareholders and to ensure transparent and informative financial reports. Considering the same, we expect the board to play an important role in improving financial disclosures.

Similarly, role of audit committee is also important. Audit Committee is required to be set up by statute. It should have majority independent directors, financial literacy for all the appointed members, and accounting expertise by at least one member of the committee. It also mandates independence of the chairperson and his presence at the annual general meeting to answer shareholder's queries related to financial statements. Considering this regulation, we expect audit committee to be more vigilant and hence play an important role in improving disclosures.

Considering the above arguments, the following hypothesis is proposed:

H1: Corporate governance (board of directors and audit committee) has positive and significant influence on financial disclosures.

3 Data and methodology

3.1 Data and sample

Our sample comprises of large listed 200 companies in India. Excluding the financial firms due to different reporting requirement and varied applicability of accounting standards, we finally have 153 firms.Though companies may disclose information in a variety of ways, the annual report is considered as the most effective and reliable source of information. We have collected information related to financial disclosure and corporate governance variables from the annual report for the year ended March 31, 2012. In order to extract the information items, financial and non–financial items of the annual reports were considered. This included reports of directors, report of auditors, corporate governance report, statement of accounting policies, profit and loss account, balance sheet, statement of cash flows, and finally, notes to the accounts.

Disclosure Index

There are 32 Indian Accounting Standards (AS) issued by ICAI, which are applicable to the Indian companies as on 31st March 2011. We consider the 29 mandatory AS for this study, which has to be complied by every listed firm across industries. Each standard lays down suggested disclosures required by the firm based on the accounting transactions. A comprehensive index is created comprising of 171 disclosure items from the accounting standards to ensure objective measurement. Table 1 enlists the number of disclosures drawn from each AS. In addition, appendix A.2 provides an example of the process of making the disclosure items taking the case of AS- 2 and AS-6.

INSERT TABLE 1 HERE

Further, an equally weighted disclosure index is computed and each item is coded based on disclosure. Each item is given the weight of 1 and coded as 1 if disclosed, 0 otherwise, and NA if not applicable. Then, the disclosure score was computed by dividing total no. of disclosures complied by a firm with total no. of disclosures applicable for that firm.

DI = Total No. of Disclosures Complied / (Total Disclosures – Disclosures Not Applicable)

3.2 Corporate Governance Index (CG Index)

CG covers a number of internal and external mechanisms that reduce agency cost within a corporation and thereby lead to an increase in firm value. In the case of emerging economies including India, family owned companies dominate the corporate scenario. Thus, there are many issues like multiple directorships, board size, and duality apart from board independence, which may affect board decisions by substantial equity stake and holding important managerial positions. We consider the important governance mechanisms to capture the overall state of corporate governance of a firm. The CGI developed by the present study has two sub-indices having 17 attributes. We now discuss each of the identified mechanisms for CG index.

The Board of Director Sub Index

The Board of directors is the backbone of corporate governance as they decrease agency cost by monitoring and rewarding top executives, leading to shareholders wealth maximization. They are accountable for setting objectives, monitoring and controlling firm's actions, which aligns managers and shareholders interest (Fama and Jensen, 1983). They are legal representatives of shareholders and have fiduciary obligation to monitor management (Black, 2000; Vanden Berghe and Levrau, 2004).They also provide knowledge, advice, and business networks to aid management in improving financial performance (Harris and Raviv, 2008; Pugliese *et al.,* 2009; Zahra and Pearce, 1989) and efficiently represent shareholders in designing management compensation (Kumar and Sivaramakrishnan, 2008).

Boards comprise of executive directors who are full time employees and are responsible for regular activities and non-executive directors who normally offer consultative role. The non-executive directors are further classified as affiliated directors and non-affiliated directors. Affiliated directors are former employees, relatives of company officers or persons having business relationships with the firm such as lawyers and investment bankers. The non-affiliated directors are the independent directors who perform the monitoring role and have fiduciary duties towards shareholders interest. There should be an appropriate balance between executive and non-executive directors on the board. In the absence of governance, codes that may recommend varying proportions of non-executive directors this balance may be determined endogenously (Hermalin and Weisbach, 1998).

It is advisable to have a higher proportion of non-executive directors in the board, which helps to reduce agency cost. Proponents support this view by demonstrating that higher levels of non-executive directors on the board undermine the negative relationship between the firm's investment opportunities and firm's performance (Hutchinson and Gul, 2004).Also, event study analysis demonstrate that the appointment of non-executive directors increases firm value (Rosenstein and Wyatt, 1990,97; Shivdasani and Yermack,1999). However, opponents of non-executive director fail to acknowledge such relationship (Coles *et al.,* 2001; Weir *et al.,* 2002; De Jong *et al.,* 2005). Few researchers even found a negative relationship between non-executive director representation and performance (Weir and Laing, 2000).Following the discussion, we consider eleven attributes stated in Figure1, followed by their explanation that describes the state of governance with respect to Board of Directors.

INSERT FIGURE 1 HERE

The Audit Committee Sub Index

This internal CG mechanism depends on the availability of accurate and timely information. The audit committee as a mechanism assures firm produces relevant, adequate, and credible information that investors as well as stakeholders can use to assess the performance of the firm. The audit committee ascertains that the audit process is carried out in a free environment, devoid of any internal control. It also ensures the engagement of external auditor for continuous monitoring of its functions and progress. These reasons placed major emphasis on the structure, role, power and functioning of the audit committee worldwide.

The audit committee needs independence from management, which is very important during verification of financial statements prepared by internal auditors, and management. Verification of financial statements requires all necessary documents and truthful explanation of all procedures, which is unexpected from management as their actions, are subject to verification. Thus there is a need to insulate the verification process from the influence of the inside management so that outsiders perceive the audit process as independent. The independence of the audit committee members is important as the monitoring they provide affects earnings quality, audit quality (Abbott and Parker, 2000) and auditor independence (Abbott *et al.,* 2004). Under these circumstances, the independence of the audit committee becomes crucial. Independent audit committees are associated with higher disclosure quality (Karamanou and Vafeas, 2005) and a lower cost of debt finance (Anderson *et al.,* 2004).

Bronson *et al.,* (2009) find the benefits of audit committees are limited unless the committee comprises independent directors only. This is the reason that worldwide regulations put major emphasis on independence of audit committee. In India though, the Clause 49 of the listing agreement require the audit committee to have two thirds of its members as ID. In addition, audit committees should have a minimum of three directors with an independent director as chairperson. We consider six attributes of Audit committee to construct Audit Committee Sub index (Figure 2).

INSERT FIGURE 2 HERE

3.3 Estimation model

In order to test our hypothesis about the likely impact of corporate governance practices (measured by CG index) on discourse (measured by disclosure Index) we construct following model with varied specifications. To test the varied specifications, we consider CG Index (CGIndex) as independent variable in Specification 1.Then, we bifurcate the CG Index into its sub-indexes in specification 2 (CGIndex_Sub_BOD) and 3 (CGIndex_Sub_AUDCOMM). Finally, we test both the sub-indexes in specification 4 to test their individual impact when they are mutually present in the equation.

Considering the impact of control variables that may likely have an impact on the study, we control for firm attributes such as firm size ($Size$), profitability (ROA), debt level (LEV), quality of audit ($Big4$), and age (LOG_AGE). Prior studies suggest that large firms can bear the cost of disclosures (e.g. Singhvi and Desai, 1971;Cooke, 1992; Joshi and Mudhahki, 2001). In addition, profitable firms (Singhvi and Desai, 1971; Belkaoui and Kahl, 1978; Wallace et al., 1994), leveraged firms (Hossain and Adams, 1995), and older firms (Owusu Ansah, 1998) are likely to disclose more than their counterparts. Audit firm (big 4) also affects the disclosure quality (Craswell and Taylor, 1992; De Angelo,1981).Appendix A.1 provides the variable definitions.

$$DS = \alpha + \beta_1 CGIndex + \beta_2 Size + \beta_3 ROA + \beta_4 LEV + \beta_5 Big4 + \beta_6 LOG\_AGE + \varepsilon \quad (1)$$

$$DS = \alpha + \beta_1 CGIndex\_Sub\_BOD + \beta_2 Size + \beta_3 ROA + \beta_4 LEV + \beta_5 Big4 + \beta_6 LOG\_AGE + \varepsilon \quad (2)$$

$$DS = \alpha + \beta_1 GIndex\_Sub\_AUDCOMM + \beta_2 Size + \beta_3 ROA + \beta_4 LEV + \beta_5 Big4 + \beta_6 LOG\_AGE + \varepsilon \quad (3)$$

$$DS = \alpha + \beta_1 CGIndex\_Sub\_BOD + \beta_2 CGIndex\_Sub\_AUDCOMM + \beta_3 Size + \beta_4 ROA + \beta_5 LEV + \beta_6 Big4 + \beta_7 LOG\_AGE + \varepsilon \quad (4)$$

4 Results and Discussion

4.1 Descriptive statistics

The level of compliance of each firm is shown by the disclosure score based on 171 items from 29 mandatory AS in table 2. Predominantly one-third companies have complied with the majority of stipulated standards. However, 25% of the sample companies still fall below the satisfactory compliance level with scores ranging from 41 to 60%.

INSERT TABLE 2 HERE

Table 3 presents the descriptive statistics for the study. We observe that mean disclosure score is 79.92% with a range from 47% to 100%.CG Index (65.31%) and BOD sub index (66.43%) almost have similar means with high mean compliance shown by audit sub index (75%).Our sample has high variability in terms of other firm characteristics such as size, age, leverage, and profitability.

The result in table 4 suggests statistically significant correlation between disclosure score and CG Index at 1% level. Individual CG sub-indexes are also significant at 5% level. Due to high correlation among cg sub-indexes, we tested for multicollinearity among the variables. However, maximum VIF score amongst all the models was 2.33, which is within the permissible range (Myers, 1990).

INSERT TABLE 3 HERE

INSERT TABLE 4 HERE

4.2 Regression Results

Table 5 includes the results of the regression of corporate governance practices on financial disclosure of Indian firms. Corporate governance is significant with a positive coefficient (β = 0.00475, t-stat = 3.04) in Model 1. This confirms the expected positive relationship between financial disclosures and corporate governance practices followed by the Indian firms.The result indicates that one percent increase in governance practices will lead to 0.004% increase in disclosure among Indian firms.

In addition, the corporate governance measured by individual sub-indexes are also significant with positive coefficient – board structure sub index (β = 0.00281, t-stat = 1.99) and audit sub index (β = 0.00243, t-stat = 2.41) in model 2 and 3 respectively. The results are in agreement with the prior studies, which provide evidence that boards reduce the dominance of CEO (Forbes and Milliken, 1999; Goodstein *et al.,* 1994) encouraging disclosures for stakeholders. Audit sub index results indicate the effectiveness of internal control and monitoring role. Their role to ensure the reliability of financial statements increases financial disclosures. These findings are consistent with DeFond and Jiambalvo (1994) who suggests that audit committee existence prevents overstatement of accounting errors. They further play a role of mediator between management and external auditors since these two parties may have legitimate differences of opinion in the application of accounting standards (Klein, 2002).

In model 4, where both the sub-indices are present in the same model, significance of BOD reduces (β = 0.00255, t-stat = 1.82). However, audit sub index retains the similar significance ((β = 0.00228, t-stat = 2.27).This indicates that audit sub index has greater relevance for firms and encourage them towards transparent and reliable financial statements.

INSERT TABLE 5 HERE

5 Conclusion

Considering the importance of disclosures and effective corporate governance in increasing investors' confidence and bringing accountability to the stakeholders, the study aims at identifying likely impact of better corporate governance practices on financial disclosure of Indian firms. In line with the existing studies, our results support the agency and the resource dependency perspective. Our result validates the existing role of boards in monitoring and hence improving the relation between shareholders and managers (Hillman and Dalziel, 2003). Similarly, our findings of board structures on disclosures suggest that board members contribute to the board dynamics by bringing varied knowledge, experience, and expertise (Hillman *et al.,* 2000; Palmer and Barber, 2001).Audit committee ensures better disclosure and equip firms to present reliable and robust financial statements. Thus, our study builds a case for firms to enhance their governance standards for quality financial disclosures.

In addition, we extend the literature by introducing the missing link of disclosure while measuring the direct economic impact of governance practices. This introduction of this gap variable – disclosure is measured by an exhaustive list of disclosures to overcome the measurement error.

Finally, our study provides useful insights for policy makers and regulators. The findings may provide feedback to the regulators on the effectiveness of the present regulations. In addition, the findings, suggest the influence of governance practices on disclosure, might help in the formulation of appropriate policies about board structure and audit function. The study also calls upon the investors to emphasize on governance quality of the investing firms.

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Tables

Table 1: No. of Disclosures considered as per requirements by AS/GAAP in India

No.	Accounting Standard	No. of Disclosures
AS-1	Disclosures of accounting policies	2
AS-2	valuation of inventories	3
AS-3	Cash Flow Statements	7
AS-4	Contingencies and Events Occurring After the Balance Sheet Date	2
AS-5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	2
AS-6	Depreciation Accounting	7
AS-7	Construction Contracts	3
AS-8	Research and Development (Withdrawn and included in AS 26)	0
AS-9	Revenue Recognition	2
AS-10	Accounting for Fixed Assets	6
AS-11	The Effects of Changes in Foreign Exchange Rates	6
AS-12	Accounting for government grants	4
AS-13	Accounting for investments	8
AS-14	Accounting for Amalgamations	9
AS-15	Accounting for Employee Benefits	13
AS-16	Borrowing Costs	2
AS 17	Segment reporting	11
AS-18	Related Party Disclosures	8
AS-19	Leases	16
AS-20	Earnings Per Share	5
AS-21	Consolidated Financial Statements	3
AS-22	Accounting for Taxes on Income	3
AS-23	Accounting for Investments in Associates in Consolidated Financial Statements	6

AS-24	Discontinuing Operations	11
AS -25	Interim Financial Reporting	11
AS-26	Intangible Assets	3
AS-27	Financial Reporting of Interests in Joint Ventures	7
AS-28	Impairment of Assets	5
AS-29	Provisions, Contingent Liabilities and Contingent Assets	6
	Total	**171**

Table 2 Range of Disclosure Score of AS by Indian firms

Compliance Score Range (%)	No. of Companies	
	Number	**Percentage**
40 to 50	6	3.92%
50 to 60	32	20.92%
60 to 70	14	9.15%
70 to 80	16	10.46%
80 to 90	33	21.57%
90 to 100	52	33.99%
Total	**153**	**100.00%**

Source: Author’s Computation

Table 3 Descriptive Statistics

	mean	p50	sd	min	max	p25	p75
DS (%)	79.92	84.00	16.87	47.00	100.00	66.00	95.00
CGIndex_Sub_BOD (%)	66.43	63.64	9.85	36.36	100.00	63.64	72.73
CGIndex_Sub_AUDCOMM (%)	75.05	66.67	13.40	33.33	100.00	66.67	83.33
CGIndex (%)	65.31	65.38	9.42	44.39	97.50	58.98	71.33
Firm Size (in Millions)	121850.50	30142.60	251847.90	937.40	1800000.00	14439.80	79377.10
Age (in Years)	38.63	30.00	25.04	4.00	140.00	21.00	55.00
Leverage (times)	0.22	0.19	0.21	0.00	0.89	0.00	0.36
ROA (%)	0.59	0.06	2.19	-0.22	20.55	0.02	0.24

Table 4 Correlation Matrix

	DS	CGIndex	CGIndex_Sub_BOD	CGIndex_Sub_AUDCOMM	Firm Size	Age	Lev	ROA	Big4
DS									
CGIndex	0.1949**	1							
CGIndex_Sub_BOD	0.1892**	0.5225***	1						
CGIndex_Sub_AUDCOMM	0.1341*	0.4553***	0.1055	1					
Firm Size	-0.0403	-0.0238	-0.1930**	-0.0696	1				
Age	0.0692	-0.046	-0.0448	-0.1132	0.0828	1			
Lev	-0.1042	0.0482	-0.057	0.0522	0.3048***	-0.116	1		
ROA	0.0182	0.1111	0.0955	0.1626**	-0.1138	0.1445*	-0.5376***	1	
Big4	0.1113	0.0774	0.1521*	0.0143	0.0427	-0.0775	-0.0253	-0.0654	1

*** $p<0.01$, ** $p<0.05$, * $p<0.10$

Table 5: Relationship between corporate governance (measured by CG Index) and financial disclosure

	(1)	(2)	(3)	(4)
CGIndex	0.00475***			
	(3.04)			
CGIndex_Sub_BOD		0.00281**		0.00255*
		(1.99)		(1.82)
CGIndex_Sub_AUDCOMM			0.00243**	0.00228**
			(2.41)	(2.27)
Firm Size[a]	0.00226	0.00133	-0.000560	0.00241
	(0.22)	(0.13)	(-0.05)	(0.23)
Age[a]	0.0129	0.0102	0.0124	0.0128
	(0.63)	(0.49)	(0.60)	(0.62)
Lev	-0.109	-0.0954	-0.107	-0.108
	(-1.63)	(-1.40)	(-1.59)	(-1.61)
ROA	0.00676	0.00797	0.00762	0.00675
	(1.03)	(1.20)	(1.15)	(1.03)
big4	0.0300	0.0281	0.0380	0.0294
	(0.97)	(0.88)	(1.21)	(0.94)
_cons	0.407**	0.573***	0.589***	0.401**
	(2.37)	(3.54)	(4.09)	(2.28)
R-square	0.107	0.075	0.086	0.107

[a] Natural logarithm

*** p<0.01, ** p<0.05, *p<0.10

Figures

Presence of non – executive or promoter chairman (Ho,2005;Brown and Caylor,2004)

Percentage of Independent Directors
(Beasely,1996;Black et al., 2006;Brickley et al.,1994;Anderson et al., 2004; Eisenberg,1976,American Law Institute,1992)

Total number of directorships held by directors (SEBI, 2000b)

Total number of committee membership held by directors (Adams,2003;Jackling and Johl, 2009; Carter et al., 2010)

CEO Duality
(Baliga et al., 1996; Rechner and Dalton,1991;Yermack,1996;Brown and Caylor,2004,SEBI, 2000B)

Board Size
(Yermack,1996;Brown and Caylor,2004;Lipton and Lorsch,1992;Conyon and Peck,1998b, Ghosh,2006)

Tenure of Independent director
(Non Mandatory Requirement –SEBI, 2004)

Board Meeting Frequency (SEBI, 2000b)

Percentage of board meetings attended by the directors (SEBI, 2000b)

Gap between board meetings (SEBI, 2000b)

Percentage of directors who attended Annual General Meeting (AGM) (SEBI, 2000b)

Literature: Fama & Jensen, 1983a; Williamson, 1964,81,83; American Law Institute,1992; Eisenberg, 1976

Figure 1Board of Directors Sub Index

Qualified Auditor Report (SEBI 2000b)

Percentage of independent directors (Klein,2002;Brown and Caylor,2004;SEBI, 2004)

Audit Committee chaired by Independent Director (SEBI 2000b)

Presence of the Chairman in the AGM (SEBI, 2000b)

Number of Audit Committee Meetings (Abbott and Parker,2000;SEBI, 2004)

Quorum at the Audit Committee Meeting (SEBI, 2000b)

Literature: HO,2005;Wallace, 2004; Adams,2003; Anderson et al., 2004;Deli and Gillan,2000;Klein,2002;SEBI, 2004; Naresh Chandra Committee Report,2002

Figure 2 Audit Committee Sub Index

Appendices

A 1 Variable definition

Variable	Definition
Dependent Variable	
DS	Disclosure score computed by using 171 disclosure checklist points from Indian Accounting Standard
Independent variables- Corporate Governance Variables	
CGIndex	Index with 17 attributes on board and audit committee structure
CGIndex_Sub_BOD	Index with 11 attributes on board structure
CGIndex_Sub_AUDCOMM	Index with 6 attributes on audit committee structure
Control variables	
Firm Size	Natural logarithm of total assets
Age	Natural logarithm of firm age
Lev	Long term borrowings scaled by total assets
ROA	Net earnings before extraordinary items scaled by total assets
Big4	Dummy variable coded as 1 if audited by Deloitte, E & Y, KPMG and PwC, 0 otherwise

A 2: Construction of disclosure index

We consider disclosures required by each Accounting Standards and formulate a disclosure Index. There are 29 Accounting standards, which are mandatorily applicable to Indian listed firms. We have provided number of disclosers drawn from each AS has been provided in Table 1. In this appendix, we provide example of Accounting Standard 2 and Accounting Standard 6.

Accounting Standard 2 – Valuation of Inventories

The text of the standard[1] provide following disclosure requirement in para 26 and 27.

"26. The financial statements should disclose: (a) the accounting policies adopted in measuring inventories, including the cost formula used; and (b) the total carrying amount of inventories and its classification appropriate to the enterprise.

27. Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are raw materials and components, work in progress, finished goods, stores and spares, and loose tools"

Using the above-mentioned requirement from standard, we consider following checklist points in the disclosure index.

No.	Disclosure questions/points	Rating Scale 1/0/NA
AS-2	**Valuation of inventories**	
1	Has the accounting policies adopted in measuring inventories disclosed?	
2	Is the disclosure made for the cost formula used (i.e. FIFO, Weigh. Avg., Specific Identification)?	
3	Are the inventories in accounts classified into raw material, stores, work in progress, and finished goods?	

Accounting Standard 6 – Depreciation Accounting

The text of the standard[2] provide following disclosure requirement in para 17 to 19.

"17. The depreciation methods used the total depreciation for the period for each class of assets, the gross amount of each class of depreciable assets and the related accumulated depreciation is disclosed in the financial statements along with the disclosure of other accounting policies. The depreciation rates or the useful lives of the assets are disclosed only if they are different from the principal rates specified in the statute governing the enterprise.

[1] Available at http://www.mca.gov.in/Ministry/notification/pdf/AS_2.pdf (Accessed on 18th February, 2016).
[2] Available at http://www.mca.gov.in/Ministry/notification/pdf/AS_6.pdf (Accessed on 18th February, 2016).

18. In case the depreciable assets are revalued, the provision for depreciation is based on the revalued amount on the estimate of the remaining useful life of such assets. In case the revaluation has a material effect on the 62 AS 6 amount of depreciation, the same is disclosed separately in the year in which revaluation is carried out.

19. A change in the method of depreciation is treated as a change in an accounting policy and is disclosed accordingly."

Using the above-mentioned requirement from standard, we consider following checklist points in the disclosure index.

No.	**Disclosure questions/points**	**Rating Scale 1/0/NA**
AS-6	**Depreciation Accounting**	
1	Whether total depreciation for the period for each class of assets is disclosed?	
2	Whether the related accumulated depreciation is disclosed?	
3	Whether depreciation methods used is disclosed?	
4	Whether depreciation rates or the useful lives of the assets, if they are different from the principal rates specified in the statute governing the enterprise is disclosed.	
5	In case the depreciable assets are revalued, the provision for depreciation is based on the revalued amount on the estimate of the remaining useful life of such assets.	
6	Whether change in the method of depreciation is treated as a change in an accounting policy and is disclosed accordingly?	
7	If any depreciable asset is disposed of, discarded, demolished, or destroyed, the net surplus or deficiency, if material, should be disclosed separately.	