CORPORATE REPORTING PRACTICES OF COMMERCIAL BANKS IN SRI LANKA

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Abstract

Effective corporate disclosure practices are essential in achieving and maintaining public trust and confidence in the banking system, and these practices are critical to the proper functioning of the banking sector in particular and the economy in general. However, little attention has been given to the corporate governance of the banking sector especially in developing economies. The study examines corporate governance practices of commercial banks by measuring the level of corporate disclosures in the annual reports in relation to the corporate governance guidelines for Banks. This study used a descriptive research design based on secondary data obtained from published statements of accounts of commercial banks in Sri Lanka. The sample covers the annual reports of five listed and two public commercial banks whose annual reports were available for the eight-year period from 2011 to 2018. An "Index of Disclosure" consisting of items of information that should appear in an annual report, was constructed. By examining the annual reports of 2011 to 2018, the findings show a gradual increase in the level of disclosure and its categories over the observed period. The results also reveal that firm characteristics; turnover and profitability have a significant positive association with disclosure score, except assets in place.

Keywords: Disclosure, Annual Reports, Firm Characteristics, Corporate Governance.

Introduction

A large network of commercial banks, financial institutions, stock exchanges and financial instruments characterize the financial system of any country. These financial institutions and commercial banks provide a wide range of financial services to people in a country. These services include accepting deposits from the general public, granting loans and advances to individuals and companies, buying and selling of government and fixed income securities and sometimes buying and selling of shares(via stock brokering), fund transfers, standing order instructions and so on. In addition, it provides technologically advanced facilities like internet banking, payment systems, stock market performances and E-commerce that reflect all real time customer needs.

The banking system can create money. When business expands, more money is needed to perform transactions. The legal tender money of a country cannot usually be expanded quickly. Bank money can be increased quickly and used when there is a need for more money. In a developing economy, banks play an important role as supplier of money and the banking system facilitates domestic and international trade. A large part of trade is done on credit. Banks provide references and guarantees on behalf of their customers, based on which sellers can supply goods on credit. This is particularly important in international trade when the parties reside in different countries and are very often unknown to one another.

However, today banks and other financial institutions in Sri Lanka have collapsed to some extent (Priyadarshini and Thilakarathne, 2016), even if it is not significant as seen in banking sector in European countries through credit crunch. There may be many reasons for these impacts.The major cause of serious banking problems continues to be directly related to credit standards for borrowers and counterparties, poor portfolio risk management, or lack of attention to changes in economic or other circumstances that can lead to deterioration in the credit standing of a bank's counterparties. In unstable economic environments, interest rates charged by banks are fast over-taken by inflation. This makes borrowers find it difficult to repay loans as their real income falls, hence, insider loans increase and over concentration in certain portfolios increases giving rise to credit risk. In Sri Lankan context the thoughts and prospects given through annual reporting may be a cause of positive or negative thinking of customers and shareholders. Simply banks function actively via shareholders' wealth. As a result, there is a huge need to win the hearts and minds of the shareholders, through corporate reporting to make the banks financially viable. Disclosure practices play an important role in protecting stakeholders' interests and accordingly, they are important in corporate governance. There should be conformity in corporate reporting allowing the shareholders and customers to know the real time value and benefits of banks. On the other hand, the dialogue between the bank and the shareholder occurs mostly through the annual report obtained by the shareholder who has invested a significant amount of money.

Currently, the level of disclosure of annual reports is not satisfactory to attract the attention of the shareholders (Rao and Desta, 2016). Banks generally occupy a special position of trust in the national economy (Reserve bank of Malawawi, 2010). According to Bank for International Settlements (2010) effective corporate governance practices are essential in achieving and maintaining the public trust and confidence in the banking system, hence critical to the proper functioning of the banking sector and economy as a whole. Weak corporate governance system has the capacity to undermine stability of the banking system, leading to a loss of confidence in the ability of the banks to properly manage their assets and liabilities, including deposits and possible runs on banks adversely affecting enterprise and household sectors of the economy (Mustafa et al. 2009; Bank for International Settlements, 2010). In fact, weak and ineffective corporate governance mechanisms in banks have been pointed out as the main factor that contributed to the recent global financial crisis (Marcinkowska, 2012). Corporate governance is about building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that fosters good corporate performance. The current study examines corporate governance practices in commercial banks by measuring the level of corporate governance related disclosures in the annual reports of the banks. The item-wise disclosures have significant differences when presented in annual reports.

Objectives

This study has been undertaken with the main objective of analyzing the disclosure practices of the banks, which are listed, on the Colombo Stock Exchange and government owned commercial banks from the year 2010/11 to 2018/2019. In addition to the main objective, the following specific objectives have been set.

I. To study the disclosure practices of commercial banks in Sri Lanka over the study period
II. To examine the trend in the disclosure practices of the banks during the period under study; and,
III. To investigate the influence of company attributes, such as, asset size, turnover, and EPS on disclosure in the annual reports over the period under study.

Literature Review

The pioneer study on measuring corporate disclosure through index of disclosure has been, conducted by Cerf (1961). The Annual reports of 527 companies were scanned by applying the index of disclosure consisting of 31 items. The weighted index of disclosure was used in computing the disclosure score in the annual reports of all the 527 companies. The findings of this study revealed that a positive relationship existed between the disclosure scores and assets size, number of stockholders and rate of return. Based on the findings of his study Cerf (1961) suggested many areas of corporate disclosure, which needed improvement. The important areas pointed out by the study are- sales breakdown, capital expenditure (current and planned), research and development (current and planned), information on management, information on future outlook, and disclosure of accounting policies.

Chander (1992) conducted a research on corporate reporting practices. For the purpose of his study, top 50 companies were selected. The annual reports of the selected companies for the year 1980-1981 to 1984-1985 constituted the major source of data collection. It was found that there was an improvement in the disclosure practices of the public sector and the private sector giants in 1984-1985 over 1980-1981. However, he observed, comparatively higher improvement in the disclosure of the public sector companies. He also found that there was a positive and significant association between the size of the company (tangible assets) and the disclosure score in both the sectors in all five years of the study. Further, he found that there was a positive relationship between the profitability of a company as measured by ROI and the disclosure score only in the public sector.

Singhvi and Desai (1971) studied the association between company characteristics, such as, assets size, number of stockholders, listing status, CPA firms, rate of return and earning margin, and the disclosure of information. They also looked at whether disclosure had any impact on the market value of securities. Their study is based on the annual reports of 100 listed and 55 unlisted companies for the year 1965-1966. The findings of the analysis show that the extent of disclosure in companies' annual reports is positively associated with all the independent variables.

Hasan and Hosain (2015) investigated the extent of disclosure of 54 listed companies in Bangaladesh and association between company specific characteristics with disclosure level. The results indicate that firm size and status of the company significantly affect the extent of voluntary disclosure in the annual reports of Bangladesh companies. The study also found that they disclosed an average of 50.62% of the items selected during the study period.

Hawshe (2016) examined the level of voluntary information disclosure in 54 annual reports of Libyan's commercial banks over six years period from 2006 to 2011. To measure disclosure level they have developed scoring sheet comprised of 63 voluntary information items and a dichotomous scoring method was applied. The results revealed that the extent of all five types of information disclosure is lower with an average of 38%. However, there was an improvement in the general level voluntary disclosure and its categories over a six year period.

Rao and Desta (2016) investigated the effect of profitability on disclosure practices in the case of Ethiopian commercial banks using the annual reports of selected commercial banks. The disclosure level of Ethiopian commercial banks is measured by the ratio of disclosure score to maximum total obtainable score. The results indicate that the profitability of banks affects the level of disclosure of Ethiopian commercial banks. Bank size and board size have no significant relation to the level of disclosure.

Yadav and Kumar (2018) have empirically examined the extent of voluntary disclosure practices of selected public and private sector commercial banks in India for the period of 2011 to 2016. For this purpose, voluntary disclosure index has been prepared and analyzed. Bank wise voluntary disclosure indicates that the public sector banks disclosed more information compared to private sector banks.

Wickramarachchi (2002) carried out a study with the objective of examining the accounting information disclosed in annual reports of listed companies in Sri Lanka in order to understand the level of disclosure. In this study, disclosure of accounting information in annual reports of listed companies of the Colombo Stock Exchange for the financial year 1998/99 has been examined. Percentage and descriptive statistics were applied to measure the level of disclosure. The disclosure levels of accounting information items have varied from company to company. Eighteen out of the three hundred and forty items in the compiled index were not applicable to annual reports of Sri Lankan companies. Almost, half of the items were at a higher disclosure percentage level, and 24% of items were at a very low disclosure level. Disclosure of group items in balance sheet, cash flow statement, and notes on accounts were at a higher level. Disclosure of group items of future expectation estimates, social responsibility accounting, and ratio information were at a very low level. There was no considerable difference in disclosure among the different sectors of the companies. The total disclosure among the sectors has varied between 60% and 70%.

The foregoing review of the empirical studies, conducted on the corporate disclosure, reveals that no comprehensive study has been conducted in Sri Lanka to examine the disclosure practices of companies. Moreover, the conclusion drawn by these studies are not much relevant at present, considering the fact that "corporate disclosure" has caught much attention of the corporate sector, professional bodies and users of the annual reports. The present study is an attempt to analyze the disclosure practices of the listed banks in Sri Lanka under the Colombo Stock Exchange (CSE)

Hypothesis:
It was hypothesized that there are significant relationships between the bank characteristics and the disclosure score. Therefore, the following hypotheses have been formulated and tested.
H-1: Size of the bank measured in terms of its turnover is significantly associated with its disclosure scores.
H-2: There is a significant association between the assets in place and the level of disclosure in the annual reports.
H-3: Profitability measured in terms of its EPS is significantly associated with its disclosure scores.

Research Methodology

Conceptualization

The financial analysis of a company is a very significant tool used in the process of decision making particularly in investment activities.

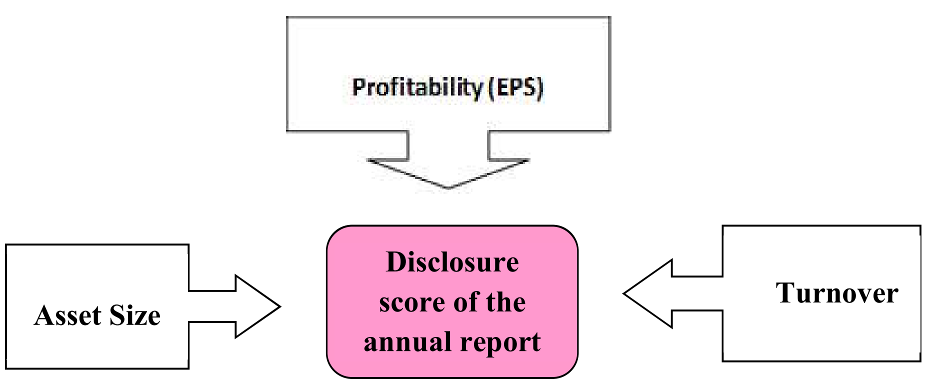

Figure 1: Conceptualization(Source: Developed based on literature review)

The financial analysis means selection, evaluation and interpretation of financial data, along with other information with a view to assisting investment and financial decision-making. One of the most fundamental facts about businesses is that the operating performance of the firm shapes its financial structure. It is also true that the financial situation of the firm can also determine its operating performance. Investors, do judge and compare the growth, profitability and financial soundness of the Bank and for this task, as key components, the size of the bank is considered through turnover, profitability is considered through EPS and assets in place too is looked at. Therefore, the emphasis on those concepts in the corporate reporting practices is paramount important. This study has tested the importance of the above-mentioned concepts towards the corporate reporting practices for the bank.

Sampling Procedure

The scope of this study is confined to an evaluation of disclosure in the annual report published by Sri Lankan commercial banks operating in both public and private sectors. Accordingly, this study used a descriptive research design based on secondary data obtained from published statements of accounts of commercial banks in Sri Lanka. The sample covers the annual reports of five listed and two public commercial banks whose annual reports were available for the eight-year period from 2011 to 2018. Accordingly, a copy of the eight annual reports for the year 2011, 2012, 2013, 2014, 2015, 2016, 2017 and 2018 were collected from each bank. Fifty-six (56) annual reports were analyzed to achieve the research objectives. These data was adopted by using the guidelines given by the Global Reporting Initiatives (GRI) and Accountability 1000 (AA1000).

An "Index of Disclosure" consisting of items of information, which should appear in an annual report was constructed based on the following. Review of literature on corporate disclosure; criteria laid down by Institute of Charted Accountants of Sri Lanka for selecting the best presented published accounts; scanning of the annual reports of the banks, which have been listed on the Colombo Stock Exchange(CSE) and guideline laid by the Global Reporting Initiative(GRI). Fifty-five items (as mention in Appendix 1) mostly relevant to the banks and financial services sector were included in the index of disclosure. Those 55 items were selected purposefully giving attention to banking operations.

Scoring of the Disclosure Index

There are two methods for determining the level of corporate discloser: weighted and un-weighted. Un-weighted scoring method was used in this study to measure the extent of disclosed information. The un-weighted approach uses a dichotomous score in which one point given, if an item is disclosed in the annual report and zero is awarded, if an item is not disclosed in the annual report. This approach has been adopted in several previous empirical disclosure studies (eg. Cooke, 1989, Hossain, 2008, and Hasan & Hosain, 2015). Un-weighted scoring method is based on the assumption that each information item in the disclosure index is considered equally important to the average user. Therefore, this approach is less subjective than the weighted average approach. For calculating item wise and Bank wise disclosure index, a score sheet for all the items was prepared for each company separately for the years 2010/11 to 2017/18, which revealed that total score which a bank had obtained. Then, the scores assigned to different items in the score sheets of all the Banks were added to calculate the item wise score. Ordinary Least Square (OLS) regression model was used to assess the effect of each corporate attributes (bank size, assets in place and profitability) on the disclosure level.

Findings and Discussion

Bank-wise Disclosure in the Annual Reports

The disclosure score has been shown as original score, which bank has taken out of 55 so as to make the disclosure of the banks comparable. The annual disclosure of each bank is presented in Table 1.The disclosure scores obtained by all the banks have improved continuously over the study period. The commercial bank has the highest mean disclosure score of 32.5 during the period of eight years and ranked first among all the commercial banks considered in the study. The second highest disclosure score has been found 30.25 and that is for the Seylan bank while 29.5 has been obtained by the Bank of Ceylon and these two banks ranked second and third, respectively. However, the lowest score is obtained by a private sector bank i.e, DFCC bank. However, steady long lasting disclosure practices have been applied by Commercial bank, PABC bank and Bank of Ceylon giving much more transparent prospectus to stakeholders. The table further revealed that the level of disclosure practices of Commercial Bank(COB) and Pan Asia Bank (PAB) gradually increased for the period 2010/11 to 2017/18. In 2010/11, disclosure score was only 29 for the Commercial Bank and 25 for the PAB. In 2017/18 the same disclosure stood at 39 for the COM and 35 for the PAB. This reflects 20.68 percent increase in disclose score for the COM and 20 percent increase in PAB. It is also noted that disclosure score of BOC has increased by 18 percent for the period of study.

Table1: Variation in disclosure scores of banks over 2010/11-2017/18 period

Bank	Disclosure Score									
	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	Mean	% Change 2011-2018
COM	29	31	32	32	33	34	34	35	32.5	20.68%
PABC	25	26	27	27	28	29	29	30	27.63	20.00%
Seylan	28	29	30	31	31	31	31	31	30.25	10.71%
DFCC	23	24	25	25	25	25	26	26	24.88	13.04%
NTB	25	26	26	26	26	26	27	27	26.13	8.00%
BOC	27	28	28	29	30	31	31	32	29.5	18.51%
PB	29	29	29	29	29	29	29	30	29.13	3.44%

Based on the analysis of the disclosure practices of the commercial banks in relation to both the item-wise disclosure and the company-wise disclosure, the following observations can be made.

There has been an improvement in the disclosure practices of banks in Sri Lanka over the period of 2010/11 to 2017/18.

1) The contemporary issues that exist in relation to corporate reporting are human rights training for security personnel (item no.59) and current expenditure on research and development even if a description of research and development is disclosed in annual reporting.
2) The greatest level of disclosure practices is recorded in the area of Accounting and Finance (Item no.1-20).

Results of Regression Analysis

In order to examine the relationship between banks' attributes and extent of disclosure score in Sri Lankan commercial banks, multiple regression analysis has been carried out. Table 2 depicts the effect of profitability (EPS), Total assets and Turn over on the level of corporate disclosure.

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.636[a]	.405	.371	2.1599

a. Predictors: (Constant), EPS, Asset size, Turnover

Table 3: ANOVA Table

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	165.118	3	55.039	11.798	.000[b]
	Residual	242.597	52	4.665		
	Total	407.714	55			

a. Dependent Variable: DS

b. Predictors: (Constant), EPS, Asset size, Turnover

Table 3: Coefficients

Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	26.627	.448		59.431	.000
	Asset size	-.002	.003	-.418	-.581	.564
	Turnover	.057	.036	1.165	1.592	.047
	EPS	.000	.000	.316	2.446	.018

The results indicate that R-square of 0.405 and F- value of 11.798 are significant at the 0.01 level. Both of these values suggest that a significant percentage of the variation in corporate disclosure can be explained by the variations in the independent variables, Earning Per Share, Total Assets and Turn Over. The regression results shown in the Table 2 reveals that the most important bank attribute that helps to explain the variations in the extent of disclosure score in the annual report of Sri Lankans' commercial banks is profitability. The regression coefficient for the profitability is 0.316, which is positive and significant at the 5 percent level of significance. This is consistent with the view that more profitable commercial banks disclosure significantly more information than do less profitable ones. This finding is also consistent with other previous studies such as Cerf (1961), Abu- Nasar and Rutherford (1994) and Hossain (2008). The second most important variable that helps to explain the extent of disclosure in the annual report of Sri Lankans' commercial banks is Turnover. It is significant at 5 percent level of significance. Findings of this study are in line with the results from previous studies as mentioned above. The positive sign on the coefficient suggest that turnover has a direct influence on level of disclosure in the banking sector in Sri Lanka. The variable assets in place are not significant. A similar result was found in Hossain (2008). This study revealed that the assets in place do not affect the level of disclosure.

Conclusions

By examining the annual reports of 2011 to 2018, the findings show a gradual increase in the level of disclosure and its categories over the observed period. Though the disclosure practices have improved over the period, it can be said that the Disclosure practices in Sri Lanka cannot be considered as satisfactory in relation to some areas like social and environmental issues and human resource accounting and these have shown improvement in other countries at present. There are steady positive improvements in disclosure practices followed by some banks such as Commercial bank, Seylan bank and Bank of Ceylon. The items providing "futuristic information" to the users, such as, profits and sales forecasts, capital and R & D expenditure for the future and major factors affecting next year performance, have not been disclosed by majority of the companies during the period under the study. This is in contrast to the practice prevailing in the Banks of countries like U.S.A. and U.K. where more emphasis is laid on the disclosure of information about the future. The results also revealed that firm characteristics; turnover and profitability have a significant positive association with disclosure score, except assets in place.

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