MD&A Reporting - A Reality Check :
A Case Study of RIL

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Abstract

Every global financial crisis leaves behind in its wake heaps of failed institutions, bankrupt nations, impoverished families and plenty of broken egos. It also leaves behind its unique argot, a special grab-bag collection of Jargon and expressions that is peculiar to the crisis and will be forgotten by the time the next catastrophe rolls around. We live in a difficult troubled times. The financial markets are crashing around us and famous financial brands look weak in the face of this meltdown. Corporate scams are not a part of natural disasters, mishappenings, accidents and terrorist attacks, which are totally uncertain but all scams are a part of shroud corporate reporting to play with the emotions of stakeholders. They are forgetting the basic purpose of corporate reporting that is to ensure accountability, transparency and good governance. Corporate reporting is to communicate — in a readily understandable way — timely, reliable and relevant information on a company's past, present and future activities to help users make economic decisions. In addition, the fact is that corporate reporting is currently going through a period of radical change which shows no sign of slowing. This gave origin to new concept of MD&A Reporting to meet global changing scenarios. Overall, in the larger interest of small investors, it is important to ensure that accounting rules are not tampered with to ensemble the financial objectives of the companies. To cover-up the slowdown, corporate must exercise caution and analyze companies' results thoroughly with the help of fair and transparent MD&A reporting.

Keywords : Corporate Reporting, MD&A Reporting

1. Introduction

Every global financial crisis leaves behind in its wake heaps of failed institutions, bankrupt nations, impoverished families and plenty of broken egos. It also leaves behind its unique argot, a special grab-bag collection of Jargon and expressions that is peculiar to the crisis and will be forgotten by the time the next catastrophe rolls around. We live in a difficult troubled times. The financial markets are crashing around us and famous financial brands look weak in the face of this meltdown. Corporate Reporting is an application of best accounting practices, compliance of law in true spirit and adherents to ethical standards for effective management and distribution of wealth and discharge of social responsibilities for sustainable development of all the beneficiaries. Reporting is important as "capital is the engine of every economy, and information is the oil that keeps the engine running smoothly. It is on this premise that the entire disclosure framework of our securities law rests." It provides information on which sound investment decisions can be made. It is, therefore, not an overstatement to say that without good information markets could not function effectively. The LPG (Liberalisation, Privatization and Globalization) has fired the competitive spirit among the corporate. It has been realized that efficiency and cost effectiveness can alone keep the throat from being cut. In their

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own enlightened self interest, the corporate need, not only to perform in the short run but also to confirm to global standards of efficiency and ethics to act fairly in the interest of all the stakeholders. Mark Twain said "In the welfare of subject lies the welfare of king." If the stakeholders are the subject, the corporate is the king! The modern corporate is based on a system of trust and confidence to fulfill the objective of long term sustainability and shareholders value. This system of corporate stewardship works effectively only when shareholders have a high level of confidence that their representatives are managing the affairs of company in their interest. "To win this level of confidence corporate leaders need a set of tools that provide greater visibility and insight into the working of management. This tool is based on "Mantra of Karma Yoga" means devotion to duty, regardless of its consequences." Management Discussion and Analysis (MD&A) reporting provide a sound base for satisfying the need of stakeholders.

In the present scenario the enterprises are not only accountable for financial results, but carry a wider responsibility towards the economy, environment and society. Good corporate governance increases the confidence of investors and results in development of capital market. It strengthens investors' trust and ensures a long-term partnership that helps in fulfilling the company's quest for higher growth and profit. This would ensure that the Indian investors are in no way less informed and protected as compared to their counterparts in the best developed capital markets. The ultimate purpose of corporate governance is to create a self driven, self assessed and self regulated organization.

The shareholders and related parties are always eager to know whether the management is doing its best towards performance and profitability of the company or whether the business is conducted to promote their economic interests. This syndrome may be considered as one of the main contributors to the philosophy of corporate governance being witnessed today. MD&A reporting is one of the key areas which perhaps the most contemporary in today's context of Corporate Finance Management. The investors now a day expect corporate boards to exhibit total transparency, not only in book of accounts, but in overall operations of the company by disclosing in their annual report detailed information on everything. "It serves the laudable purpose of giving investors important disclosures about a company's operations. It describes known trends, uncertainties or other factors that will or are reasonably likely to result in a material impact on company's liquidity, capital resources, revenues and results of operations. Beyond just pointing out known trends, managers use the MD&A to help investor interpret and understand what a trend may mean for the company going forward. Management also gives its insight into the company's operations. It is insight that helps management to communicate its understanding of the business environment to investors, and exactly this insight that investors want to see."

MD&A provides the following information:

- Brief explanation of the types of presentations that make up the basic financial statements and their relationship to each other.
- Condensed financial information allowing readers to compare the current and prior fiscal periods (GAAP) do not require the presentation of comparative financial statements; therefore, in many cases, this will be the sole source of company-wide comparative data in the financial report.
- Analysis of the company's overall financial position (net assets) and results of operations (changes in net assets).
- Analysis of the balances and transactions of major individual funds;
- Analysis of variations from the original and final amended budget for the general fund.
- Significant capital asset and long-term debt activity (e.g. major capital construction and debt issues).
- Any facts, decisions, or conditions known to be close or audit field work that are expected to have a significant effect on financial position or results of operation.

The information contained in this MD&A may contain forward looking information. Forward-looking information is subject to numerous known and unknown risks and uncertainties including, but not limited to, results of operations, financial condition, capital spending, financing sources, and commodity prices. These risks and uncertainties may cause actual events and circumstance to differ materially from those predicted.

2. Literature Review

Research on MD&A has been emerged since 1968, but it gained momentum only in late eighties after the SEC came up with modified regulations. The research in this field increased further in nineties, when the investors started talking about Corporate Governance practices. The research works have been about whether the annual reports satisfy the requirements of the regulator, the readability of the report, evolution of MD&A disclosure norms, classification of the disclosures, effectiveness of MD&A in predictive purposes etc. Bagbyet al. (1988) analyzed the history of the MD&A against the background of federally mandated disclosures and examined case law pertaining to mandated disclosures. Dieter and Sandefur (1989) reviewed the requirements of the MD&A regulation and suggested an approach for companies to use in drafting their MD&A. Cole (1990) analyzed the length, segment information and environmental matters among others issues in MD&A of S&P Top 100 companies. She concluded that most companies provide forward-looking information.

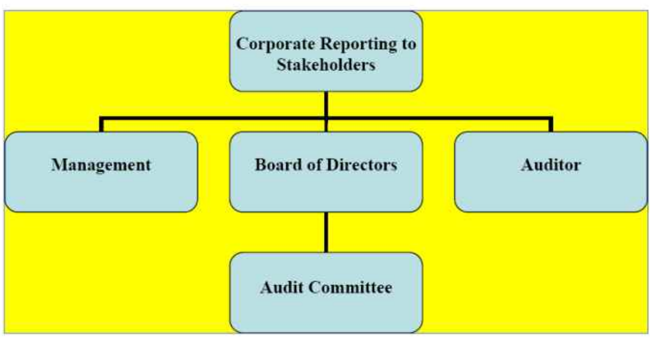
Schroeder and Gibson (1990) tested the readability of the MD&A report of 40 randomly selected companies from Fortune 500 and Fortune service 500 lists for 1986. They concluded that many of the companies did not communicate properly in the MD&A report. Bryan (1997) analyzes seven mandated disclosures contained in Management Discussion and Analysis (MD&A) to assess their information content. Generally, the results show that certain MD&A disclosures, particularly the discussions of future operations and planned capital expenditures, are associated with future short-term performance measures and investment decisions. (After controlling for information contained in financial-statement-based ratios). However, their associations with long-term results are generally not significant. The prominent among the studies aimed at analyzing the predictability of MD&A disclosures are Tennyson et al. (1990), and Pava & Epstein (1993). But there are no studies in the Indian context about the MD&A disclosures. The reason is obvious. It is just few years ago the MD&A disclosures have been made mandatory by SEBI.

3. Objectives of Corporate Reporting

The objective of corporate reporting is to communicate — in a readily understandable way — timely, reliable and relevant information on a company's past, present and future activities to help users make economic decisions. That conclusion is based on an assessment of management accountability, factors pertaining to the communication of useful information and uses for the corporate report. According to a 2005 survey by the Canadian Investor Relation Institute: "The annual report remains a core document for Canadian public companies in their communication with current and potential investors." The survey further explains that, "of all the tools used by publicly traded companies to communicate with their investors, the annual report offers the most comprehensive picture of where the company has been and where it is going." The annual report's central role in corporate reporting has, if anything, been bolstered by the increase in both its purposes and audiences. Purposes and audiences are closely interrelated, with each audience wanting different types of information in varying levels of detail. When issuing corporate reports (including annual and interim reports), management faces the difficult task of balancing the information needs of those different audiences. To communicate truly *useful* information, management has to strike a balance between the needs of its different investors as well as the needs of various non-investor groups.

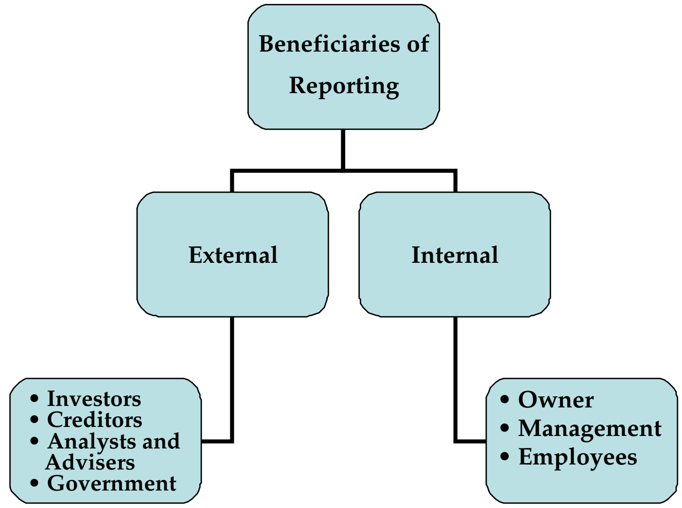
Exhibit 1.1

CORPORATE REPORTING RESPONSIBILITIES



Above exhibit 1.1 illustrates the corporate reporting responsibilities of four key groups — management, directors, audit committees and auditors. Because corporate operations are the responsibility of management, management prepares the financial statements and the other information in the corporate report. Clearly, therefore, these types of information are management's representations. The board of directors, appointed by the shareholders to oversee management, has overall responsibility for approving all corporate reports before they are issued to investors and other stakeholders. The audit committee, which oversees a company's financial operations, meets with management and auditors and reports regularly to the board. The auditor's responsibility is to form an opinion on whether the financial statements are presented fairly in accordance with generally accepted accounting principles (GAAP) and to ensure that other information in the corporate report is consistent with the financial statements. In this way, auditors add credibility to corporate reporting.

Exhibit 1.2 : Beneficiaries of Accounting Information



Above exhibit 1.2 depicts that the annual report offers the most comprehensive picture of where the company has been and where it is going to its various internal and external beneficiaries. Annual reports may be an important input to long-term investment decision making – specifically, to confirm information that investors have previously received and as a convenient summary to assist risk/return assessments. Historically, annual reports were the most accessible and comprehensive source of confirmatory information about companies. Times have changed, however, and there are now a variety of ways to communicate with investors and other stakeholders. Now, this time calls for MD&A reporting to satisfy all classes of target audiences.

4. Hypothesis of the Study

Following propositions have been examined in order to make the study more meaningful and operational as well as to analyse the impact of MD&A on different aspects.

- Management Discussion and Analysis Reporting has positive impact on company's goodwill.
- MDA reporting affects shareholders wealth.
- To analysis the relation between dividend and market capitalization and its impact on investors.
- To study the impact of MD&A Reporting on value of shares.

5. Research Methodology

Necessary information with regard to present study was collected through primary and secondary data. The primary data was collected through structured schedule about role and effectiveness of MD&A Reporting among the managers, investors, auditors and society at large. Secondary data was collected through Centre for Monitoring Indian Economy (CMIE) data of joint stock companies listed in Stock Exchanges in general and Reliance Industries Limited (RIL) in particular. Period of study is ten years.

Referred magazines and journals were also used to provide some deep insight in the subject. Economic Dailies were used for making the proposed study more innovative and updated.

Besides statistical tools averages, mean deviation, standard deviation, correlation and t–test has been applied to develop a scientific and analytical base to the present study.

Testing of hypothesis with purview of MD&A Reporting in Reliance Industries Ltd.

Exhibit – 1.3 : Effect of MD& A Reporting on Company's Goodwill

Book Value of Shares X	(X-Mean)=d	d^2
129.8	-141.25	19951.56
129.9	-141.15	19923.32
140.1	-130.95	17147.9
199.2	-71.85	5162.423
217.2	-53.85	2899.823
246.7	-24.35	592.9225
289.9	18.85	355.3225
357.4	86.35	7456.322
440.0	168.95	28544.1
560.3	289.25	83665.56
ΣX=2710.5		**185699.27**

N=10

Mean = ΣX/N,

= 2710.5/10

= 271.05

Variance = $1/n\ \Sigma\ (x\text{-mean})^2$

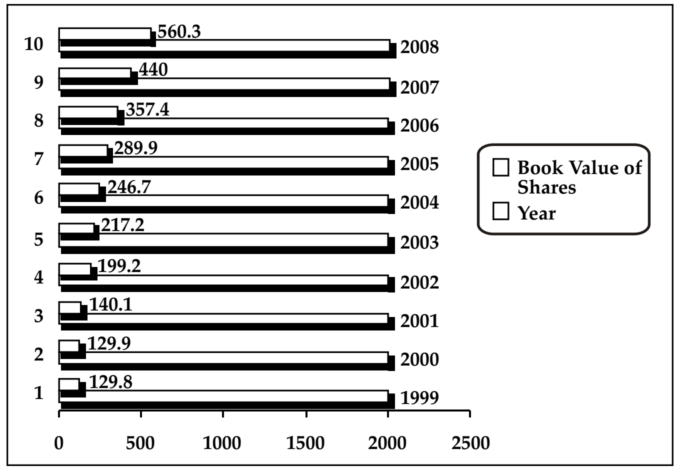
= 1/10×185699.27

= 18569.93

The value of variance is greater then that of mean which shows the greater fluctuation in the value of shares especially after the introduction of MD&A Reporting.

Year	Book Value of Shares
1999	129.8
2000	129.9
2001	140.1
2002	199.2
2003	217.2
2004	246.7
2005	289.9
2006	357.4
2007	440
2008	560.3

This fluctuation in the value of shares depicts the continuous increase in the value of shares of the company in the terms of investors' ultimate satisfaction which ultimately correlates the enhancement of the goodwill of the company. The book value of shares is showing an increasing trend since the inception of MD&A in2002 as per following graph.



Affect of MD&A Reporting on Shareholders Wealth

- In order to see the impact of MD&A reporting on shareholders wealth following hypothesis test-'t' has been used.
- Let the net worth (shareholders wealth be represented as X before the introduction of MD&A Reporting in India and net worth after the introduction of MD&A Reporting as Y.

- H0: $\mu1=\mu2$ which is equivalent to test H0: D= 0
- Ha: $\mu1<\mu2$ (to prove that the MD&A reporting has positive affect on shareholders wealth) paired T-test is used to workout the test statistic't' where t= D – 0 / σdiff /√n.

Where $\overline{D}$ = ΣD /n

= -170820 /5

= -34164

σ diff = $\sqrt{\Sigma D^2 - (\overline{D})^2 \times n / n-1}$

= $\sqrt{6334093886-(-34164)^2\times 5/5-1}$

= $\sqrt{498199406/4}$

= $\sqrt{124549851.5}$

σ diff = 11160.19

t = $-34164 - 0/11160.19/\sqrt{5}$

= -34164/4990.98891

t = -6.85

Degree of freedom = n -1, = 5 -1=4

Table value of t distribution for 4 degree of freedom is -
R : t<-0.304

While the observed value of 't' is -6.85, this falls in rejection region. Which specifies the rejection of hypothesis that MD&A has no affect on the shareholders wealth? It is concluded that MD&A reporting in Reliance Industries Ltd. has positively affected the shareholders wealth resulted into the enhancement of shareholders faith in the working of the company.

Relation between Dividend and Market Capitalization :
To judge the impact on investors two variables are taken into account that is dividend and market capitalization.

Exhibit 1.4 : Affect on Shareholders Wealth

Years	Net-worth = X Before MDA Reporting	Years	Net-worth = Y after MDA Reporting	Difference D=X-Y	D^2
1999	12369	**2004**	34453	-22084	487703056
2000	13983	**2005**	40403	-26420	698016400
2001	14765	**2006**	49804	-35039	1227731521
2002	27812	**2007**	63967	-36155	1307184025
2003	30327	**2008**	81449	-51122	2613458884
				ΣD= -170820	ΣD^2 =6334093886

Exhibit 1.5 : Correlation between Dividend and Market Capitalization

Year	Dividend % X	x= X-mean	x^2	Market Capitalization Y	y= Y-mean	y^2	xy
1999	37.5	-31	961	12176	-83579.8	6985582968	2590973.8
2000	40	- 28.5	812.25	33346	-62409.8	3894983136	1778679.3
2001	42.5	- 26	676	41191	-54564.8	2977317399	1418684.8
2002	47.5	- 21	441	41989	-53766.8	2890868782	1129102.8
2003	50	- 18.5	342.25	38603	-57152.8	3266442548	1057326.8
2004	52.5	- 16	256	75132	-20623.8	425341126.4	329980.8
2005	75	6.5	42.25	76079	-19676.8	387176458.2	-127899.2
2006	100	31.5	992.25	110958	15202.2	231106884.8	478869.3
2007	110	41.5	1722.25	198905	103149	10639757461	4280691.8
2008	130	61.5	3782.25	329179	233423	54486390298	14355526.8
Total	**685**	**0**	**10027.5**	**957558**	**0**	**86184967062**	**Σxy =27291937**
Mean	**68.5**			**95755.8**			

$r = \Sigma xy / \sqrt{\Sigma x^2 \Sigma y^2}$
Where x = X - mean
and y = Y - mean
$r = 27291937 / \sqrt{10027.5 * 86184967062}$
Hence, r = 0.928

As per the above hypothesis testing the equation describes that the degree of correlation between two independent variables 1st Dividend and 2nd Market Capitalization is 0.928 which shows the high degree of correlation among the two. As the dividend payment increased from year to year there is positive enhancement in the market capitalization of the company. The study of this correlation shows that to win the confidence of shareholders and investors the financial reporting is much more important then the non-financial reporting much more important then the non-financial reporting from which no conclusions can be drawn by a lay man whiout the help of experts.

6. Conclusion

The study indicates the impact of MD&A reporting on shareholders wealth as well as on company's goodwill. There is still a great scope of future strengthening management discussion and analysis reporting with the purview of corporate governance norms. MD&A is still in its infancy stage and every listed company is using its own standards to present MD&A as a part of Director's Report. It is concluded that MD&A reporting in has positively affected the shareholders wealth resulted into the amplification of shareholders faith in the working of the company. Hence, MD&A reporting is truly a peeping into the working of corporate through the eyes of management. The fact is that corporate reporting is currently going through a period of drastic change which shows no sign of slowing. Given that rate of change, and given the impact which reporting can have, even companies that do not want to be at forefront will want to be able to manage this agenda, rather than have it manage them. The change is expected to continue.

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