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The Role Played by Voluntary Disclosure Practices in Financial Reporting Transparency

ORIGINAL ARTICLE

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Abstract

The present article discusses the role of voluntary disclosure practices in transparency in financial reporting. The term transparency here means the extent to which the investors can access the financial information includes the share valuation, credit worthiness and ultimately the financial position of the company. Disclosure is a detailed statement about the transactions. The present work identifies features and benefits of voluntary disclosure practices, the role played by the voluntary disclosures in the efficient working of financial reporting. It also improves the competitiveness and presently the firms considered the voluntary disclosure as opportunity rather than burden. This paper discussed the value of financial reporting openness and its drawbacks. It also emphasizes the problems and effects of information disclosure that is given voluntarily. Therefore, the goal of this study is to determine the extent to which voluntary disclosure methods increase financial reporting openness.

Key Words

Financial Reporting, Information Risk, Transparency, Voluntary Disclosure.

Introduction

The increasing emphasis on voluntary disclosure and increased transparency is mostly due to the fact that these two concepts serve as the cornerstones for safeguarding shareholders' rights. Complete disclosure procedures and openness in financial reporting can foster an atmosphere of trust and increase the investment community's confidence. Voluntary disclosure promotes business success and safeguards shareholder interests. On the other hand, opaque disclosure policies may lead to unethical and suspect activity that lowers a firm's valuation.

Full disclosure and openness in financial reporting are strategies that can foster a secure environment, ensure the protection of all stakeholders, particularly investors, and boost profits. The lack of clarity and ambiguity in reporting the suspicion of immoral behaviour may lead to reduction in the value of the company. If a firm become a voluntary disclosure practitioner, it automatically builds the reputation in the industry. The information risk can be reduced by enlightening the practices of voluntary disclosure.

Review of Literature

1. (Elfeky, 2017) this paper criticises the traditional practices of firms during financial presentation and interpretation. Better interpretations help the shareholders to confidence. Millions of documents revealed the offshore tax practices of vast corporations and wealthy individuals. It also specifies the Canadian revenue agency.
2. (Saberi et al., 2019) this paper describes the theories and determinants of voluntary disclosures. The determinants here mentioned were the factors which constitute the concept. Theories always boost up the concept also. Both these factors will path a new way to the emerging system.
3. (Abu Alia et al., 2022) the writer here completely analysed the merits and demerits of the concept of voluntary disclosure and also discuss in what extend the reporting standards helps in better practices. For the evidence the writer provides some examples with quoted notes.
4. (Saha & Kabra, 2022) the article titled corporate governance and voluntary disclosure an evident from India, is a detailed study on disclosure practices in the basis of corporate governance. The term corporate governance is of course a voluntary concept, and nowadays it become mandatory concept in some extend. The new companies act states that all the listed companies should set apart a portion of two percentages of their net earnings for corporate social responsibility. These all are covered under this paper.
5. (Ronoowah & Seetanah, 2022) this paper shows disclosure mandatory themes.
6. (Mekaoui et al., 2022) writer exhibits all the standard setting formalities atre in the manner of investing public criteria.

Objectives of the Study

1. To study the concept of voluntary disclosure practices.
2. To discuss the role of voluntary disclosure practices and transparency in financial reporting

Methodology

The study entitled "The Role of Voluntary Disclosure Practices in The Transparency of Financial Reporting." is descriptive in nature. Secondary data is used for the study. Data regarding the human resource accounting and reporting standards are collected from various published and unpublished sources

Data Collection

The Voluntary Disclosure

There is a big gap or difference among giver and receiver. Here the giver indicates corporate and the receiver is investing public. They should think that they get everything they want, but the case is the corporate only explore the events which are favoring them. The receiver or investing people makes the information more wisely to get better investment decisions. Here are the important lies that the full disclosure, it provides valuable insights into internal structure. This provides forecasting of management for better planning.

Voluntary disclosure provides valuable insight into internal structure and management policies of a firm. Firms provide voluntary disclosure such as release of earnings forecast by management, investor and analyst meetings, conference calls, press releases, investor presentations, investor relation disclosure on company websites, and required statutory filings.

Role of Transparency in Financial Reporting

Transparency is the prompt and appropriate disclosure of a company's operating and financial results as well as its corporate governance practices relating to its ownership, board, management structure, and procedures. As a crucial component of corporate governance, transparency plays a significant role in determining how appealing a company is to investors. The level of transparency is a function of management's readiness and capacity to address any informational gaps with market participants. Capital markets will only survive in the long run if an environment of open information is created.

Honesty in Financial Reporting is essential in today's information economy. Companies who don't meet the transparency criterion run the risk of having their management's credibility severely damaged. In the worst situation, businesses may experience a decline in shareholder confidence, which might harm their market capitalization, credit standing, and liquidity. On the other hand, increased voluntary disclosure has benefits for creating a transparent system. Transparent financial reporting and voluntary information disclosure aid businesses in creating long-lasting competitive advantages.

Characteristics of Voluntary Disclosure

By balancing knowledge not only between investors and corporate management but also between various investor groups, voluntary disclosure lessens information asymmetry. Depending on how useful this information is, voluntary sharing may or may not reduce information asymmetry. However, voluntary disclosure only lessens information asymmetry when it is beneficial.

- Relevance, reliability, comparability, timeliness, and understandability are the five primary qualities that are seen as desired for the fulfillment of the information's usefulness.
- Voluntary information must be pertinent to investors in order to be useful. When information influences investors' choices by assisting in their assessment of the history, present, and future of a company and the environment in which it operates, such information is relevant. It must be trustworthy in order to be effective.
- It must be correct for it to be dependable.
- Information must also have the comparability feature in order to be valuable. It must permit both intra-firm and inter-firm comparison in order to be considered comparable. To get information to end consumers as quickly as feasible, it must include the timeliness feature.
- In today's information economy, where company is undergoing rapid change, timely information is crucial for closing the information gap. To be useful, information must be presented in an intelligible manner. In other words, simply giving data is insufficient; additionally, explanations or mathematical techniques are required.

Significance of Voluntary Disclosure and Transparency

The disclosure made voluntarily goes above and beyond what is required for regulatory filing. Although it is not legally mandated, voluntary disclosure is the process of sharing information with the financial markets from the reporting firm. Firms voluntarily divulge information that is not needed by the enforcement authorities in an effort to influence the opinions of other stakeholders and market participants in order to gain better terms of exchange with them. Information asymmetry and low transparency are related.

Low transparency implies that the investing community is not given access to enough information, which in turn suggests that there is an information gap between those who are aware of the information and those who are not. Therefore, there ought to be more "information premium" as a result of this higher informational asymmetry. The present value of anticipated future net cash flows, discounted at the proper risk-adjusted rate of return, is what is meant by the term "firm value" in an efficient market. Therefore, the purpose of financial disclosure is to give investors information they may use to evaluate the magnitude, timing, and uncertainty of future cash flows. An effective allocation of resources in the economy is facilitated by the useful information offered by voluntary disclosures to investors and other users of a firm's disclosure.

Benefits of Voluntary Disclosure

Firms today understand that they have tremendous incentives to maintain high disclosure standards in order to prevent surprises. With more accurate information, firms and investors can coordinate their capital investment decisions more effectively. Investors' prices are more accurately reflected by a higher rate of discounting of firms' anticipated cash flows. Capital market efficiency allows for accurate valuation of business disclosure over time. "Information premium" refers to the intrinsic worth of upcoming disclosures by the company. The "information premium" for companies with high-quality voluntary disclosure is anticipated to be steady in comparison to rivals with comparable asset and market conditions but with lower-quality disclosure.

The most important benefits of complete disclosure and better communication are:

- Greater analyst support.
- Improved access to capital with a lower cost of capital.
- Improved relationships with the investment community.
- More long-term investors.
- Higher trading volume.
- Higher institutional ownership.
- Increased liquidity.
- Decreased volatility.
- Decreased bid-ask spread.
- Higher share prices.

Among all the advantages, management reputation is undoubtedly the most significant. It is unquestionably necessary for the realization of others. The market will accept management's decisions if it has credibility, even if they short-term dilution of current earnings. Increased voluntary disclosure lessens knowledge gaps between management and investors, which enhances the stock's liquidity. The stock should be more appealing to institutional investors due to increased liquidity. The advantages of greater disclosure include enhanced liquidity, which encourages greater institutional ownership and analyst support, all of which lower the cost of capital.

Today, companies are assessed based on their disclosure practices. By creating an Information Disclosure Committee, businesses can improve their stakeholder information disclosure procedures. This committee chooses the methodology, topic, and amount of disclosure for significant information. Information that is deemed important to stakeholders but is not subject to mandatory disclosure obligations is published voluntarily.

Major Issues in Voluntary Disclosure

Companies voluntarily provide information in an effort to lower information risk, but they also aim to avoid creating a pattern of disclosure that will be challenging to uphold in the future. Firms must compare the possible advantages of increased disclosure to the specific cost factors in order to determine the best amount of disclosure. The expense of gathering and disseminating the information as well as the cost of a competitive disadvantage due to voluntary disclosure must be weighed against the considerable advantages of expanded disclosure.

In general, preparation and distribution costs are not extremely high, especially for large businesses. Additionally, the company is responsible for covering these costs, yet many end consumers gain from it. Therefore, it is economically sensible for the company to take action to prevent the various private gathering of the same information. The availability of firm-sensitive and crucial information that could help rivals is a significant problem with voluntary disclosure. As a result, the cost of a competitive disadvantage due to their disclosure is increasingly significant for many organizations.

However, one must keep in mind that every company that experiences a competitive disadvantage due to disclosure could experience a competitive benefit due to comparable disclosure by rival firms. The idea of net competitive disadvantage from transparency is therefore created. The Financial Accounting Standards

Board (FASB) states that the type of information, the level of detail, and the time of disclosure are the three variables that influence whether or not knowledge results in a competitive advantage. Companies may come to the conclusion that enhanced voluntary disclosure is favored if the expense of information collecting and dissemination does not outweigh the overall value.

Conclusion

Traditional financial reporting is becoming more and more disengaged from shareholders' expectations and needs for making wise investment decisions. Markets have started to reward disclosure methods that go beyond the strict parameters of traditional financial reporting, as well as using reporting practices as a proxy for managerial excellence. Uncertainty is brought about by companies' incomplete information among stakeholders. Investors and creditors are exposed to information risk as a result of this uncertainty, and as a result, they expect a greater rate of return on their capital.

Lower stock prices occur from higher cost of capital for the company, which is caused by higher rate of return. Increasing investor understanding and trust through voluntary disclosure methods lowers the uncertainty surrounding the returns to capital providers, which is again anticipated to lower the firm's cost of external capital and raise its value. Sound disclosure procedures lessen the danger of increased taxes, lawsuits, and excessive regulation as well as the political costs of non-compliance.

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