Interim financial reports form part of the total process of financial reporting and are prepared for and presented to the many users of financial reports for the purposes of making economic decisions.

This is the fourth edition of the research report and forms part of ongoing research initiatives by the School of Accountancy. We are of the opinion that the examination of the disclosure issues regarding interim financial information and the issues surrounding independent auditor involvement with such information as presented in this report, will contribute to a better understanding of current practice in South Africa. This in turn could facilitate improved disclosure and reporting, as well as the continuous monitoring of the appropriateness and relevance of the requirements, standards and practices in respect of interim financial reporting.

The research report investigates, firstly, the extent to which companies listed on the Johannesburg Stock Exchange in South Africa adhere to the relevant statutory and regulatory disclosure requirements regarding interim financial reports, secondly the degree to which these companies already adhere to the requirements and recommendations of the international and local accounting standards on interim financial reporting, and thirdly some of the key issues regarding independent auditor involvement with interim financial information. The basis of the research report is a survey of the published interim reports (with interim dates falling within the 1999 calendar year) of 50 top companies listed on the Johannesburg Stock Exchange.

Compliance with statutory and regulatory disclosure requirements

The interim financial reports of listed companies are subject to the requirements set out in the Companies Act, No 61 of 1973 (as amended) and the JSE Listing Requirements. The interim reports selected were evaluated against 26 criteria representing selected statutory and regulatory disclosure requirements in respect of interim financial reporting. It is reasonable to assume that users of interim financial information would expect accountable communication and disclosure, which include compliance with these prescribed statutory and regulatory disclosure requirements.

A 100% compliance has been achieved in the case of only three evaluation criteria. In other words, only in the case of three statutory and regulatory disclosure requirements do all the surveyed companies’ interim reports for 1999 comply in full. This should be viewed in the context that in principle compliance with all 26 criteria should be 100%.

The following areas of weakness, in particular, need to be addressed as a matter of urgency:

- Company directors do not adequately indicate their approval of the interim reports. This weakness relates to two aspects of approval, namely (1) a statement that the interim results have been approved by the directors, and (2) visible evidence of approval by signing the interim report - two directors have to sign the interim report on behalf of the Board.

- 34% of companies only disclose net interest paid or received, without an indication as to how the net amount has been calculated, which is required by the JSE Listing Requirements. The gross amount in respect of interest paid must be disclosed separately. This consequently also leads to companies...
not disclosing net income before interest paid and taxation as a separate line item in the income statement.

- 60% of the companies surveyed fail to distinguish clearly between non-interest bearing debt and interest bearing debt.

- Two of the companies surveyed had an exceptional increase in borrowings. Neither of these companies however adhere to the JSE Listing Requirements requiring that the effect of such an increase on earnings per share must be stated.

The extent to which the 50 companies selected, with regard to certain reporting issues, already adhere to international and local developments in respect of interim financial reporting is highly commendable. Also important is the fact that the application of a number of reporting issues require significant improvement to bring them up to par with international and local standards. Individual companies should use this opportunity to identify their disclosure issues upon which they can improve. Two major issues which were identified in this regard are:

- A statement that the same accounting policies and methods of computation are followed in the interim financial statements as compared with the most recent annual financial statements should be furnished.

- A condensed statement showing either (i) all changes in equity or (ii) changes in equity other than those arising from capital transactions with owners and distributions to owners should be furnished.

**Overall adherence to the statutory and regulatory disclosure requirements for all 50 companies is 79%. This is a relatively high percentage and one might be tempted to conclude that this result is commendable. In our opinion however, the results indicate that an acceptable level of compliance has not yet been achieved,**

An additional analysis of the original survey results indicates that no company achieved 100% compliance. Overall adherence to the statutory and regulatory disclosure requirements for all 50 companies is 79%. This is a relatively high percentage and one might be tempted to conclude that this result is commendable. In our opinion however, the results indicate that an acceptable level of compliance has not yet been achieved, because all the evaluation criteria selected represent disclosure requirements of the Companies Act and the JSE Listing requirements.

The purpose here is not to comment on the relevancy or the usefulness of the disclosure requirements concerned, but rather to measure the extent of compliance achieved.

**International and local accounting standards**

Until recently there were numerous uncertainties about which principles should apply in respect of the preparation of, and disclosures in interim financial reports in order to ensure fair presentation. International Accounting Standard, IAS 34, and local Statement of Generally Accepted Accounting Practice, AC 127, now provide significant guidance in this respect.

The accounting standards concerned were not yet compulsory for the majority of the interim reports surveyed. The results of the current survey indicate the extent to which companies listed on the Johannesburg Stock Exchange already adhere to the relevant disclosure requirements, represented by 22 reporting issues.

The suggested public announcement is deficient in many respects and only leads to uncertainties which highlight key limitations of independent auditor involvement with interim financial information.

**Voluntary audit reviews of interim financial information do not enjoy wide acceptance and there has been a decline of 11% from 1998 to 1999.**

**Independent auditor involvement with interim financial information**

A major characteristic of company interim financial reports is that they are mainly unaudited. This raises an important issue about the credibility and reliability of the interim information for investment decision-making purposes. Both internationally and in South Africa there has been a movement to involve the external auditor with company interim reports to enhance credibility and reliability, and thereby to improve governance and accountability towards the users of interim financial reports. Research and relevant developments indicate that this is still a contentious and largely unresolved issue.

The current situation in South Africa can be summarised as follows: The JSE Listing Requirements state that when a company’s audit report on its latest annual financial statements contains a disclaimer of opinion or an adverse opinion, the subsequent unaudited interim report should be reviewed by the company’s auditors in accordance with the guidelines issued by the South African Institute of Chartered Accountants. When an audit review is performed, an option exists to either include the auditor’s review report as part of the interim
report, or to publish a public announcement regarding the audit review as part of the interim report.

In the case of an audit review engagement, an unqualified report by the auditor expresses a moderate level of assurance that the information concerned is fairly presented in all material respects. The auditor concludes that the information appears to be worthy of belief and therefore it is assumed that it needs no modification so as to fairly present the financial position, results of operations and cash flow of the company in accordance with generally accepted accounting practice.

The following five issues surrounding the external auditor's involvement with interim financial reports in South Africa have been examined:

1. The means by which auditor involvement is communicated.

The existence of the option to either include the auditor's review report as part of the interim report, or to include a public announcement regarding the audit review, is undesirable. There appear to be no fundamental principles to justify this choice. The suggested public announcement is deficient in many respects and only leads to uncertainties which highlight key limitations of independent auditor involvement with interim financial information. In our opinion, if an audit review was conducted, the auditor's review report should be published as part of the interim report.

2. The status of independent auditor involvement in South Africa.

An analysis of the interim reports of the 50 companies selected indicates that eight interim reports have been subjected to audit review and that 42 interim reports have neither been audited nor reviewed. All eight of the companies concerned voluntarily subjected their interim reports to independent audit review. Voluntary audit reviews of interim financial information do not enjoy wide acceptance and there has been a decline of 11% from 1998 to 1999. The conclusion reached is that formal reviews of interim financial information by external auditors are not regarded by companies as a crucial component in respect of enhanced credibility, because had they been, companies, almost without exception, would have subjected their interim results to audit review.

3. Compliance with regulatory and professional reporting requirements by public audit review announcements.

Overall adherence for all the companies surveyed is 46%. This represents a decline of 19% compared to the 1998 interim reports surveyed in the third edition of the research report. The observed level of non-compliance means that users of interim reports are denied vital information relating to the quality of the review, the objective of the review, the nature and extent of the procedures performed and the level of assurance provided by the auditor. Non-compliance with stated reporting requirements diminishes the value of the audit review to the users of interim reports to such an extent that it might no longer be relevant to the financial reporting process.

4. Companies' reasons for not subjecting interim results to independent audit review.

Reasons for not-review decisions forwarded by listed companies provide compelling evidence on top management's view of the auditor's contribution in terms of a formal review of interim financial information. Companies don't wish to incur the additional cost of an audit review. According to them they receive very little in return: The audit review adds little value (credibility) for the directors or other stakeholders - it is seen as an unnecessary waste of money and management time. At most, an informal review by the auditors or consultation with the auditors regarding the interim financial information can be viewed as a direct service to top management and the corporate governance structures (e.g., the audit committee), if and to the extent that they require it.

5. Reviewed interim reports' compliance with statutory and regulatory disclosure requirements.

Overall adherence to specific statutory and regulatory disclosure requirements by reviewed interim reports compared to interim reports that were not subjected to independent audit review has been recorded as 74% and 80% respectively. This indicates that the involvement of the auditor does not impact on the degree to which interim reports are prepared in compliance with the disclosure requirements concerned, raising an important concern with regard to the relevance of independent auditor involvement with interim financial information. Users might have certain expectations in this regard and therefore in the end misinterpret the auditor's involvement.

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