Auditor reviews of interim financial information in South Africa: Discourse of the history of developments and their implications

WJJ Botha
School of Accountancy
University of Pretoria

ABSTRACT

Company interim financial reports provide decision useful information to a variety of their users. The debate surrounding the issue of independent auditor involvement with such reports started in the 1960's in the USA and is ongoing internationally. Today the general trend is that when auditor involvement is required, it takes the form of a review of the interim results. In South Africa, also, the auditor review of company interim reports has undergone major developments and change. The objective of this paper is firstly to determine through examination of the history of developments regarding the auditor review of interim financial information, the factors, issues and considerations which influenced current South African practice and secondly to identify the implications thereof for the auditing profession. Specific emphasis is placed on how relevant events/developments reflect on the standard setting process. The discourse presented herein supports a conclusion that present practice in respect of auditor reviews of company interim financial information in South Africa is the result of a deficient standard setting process which, in the main, fails to recognise and implement the defined principles of sound and socially acceptable standard setting. The auditing profession's ignorance of these principles will continue to foster deficient standards which are rejected by the users of auditing services and which marginalise the role and functions of the external auditor.

This article is based on a paper presented at an Accounting History Colloquium on International Perspectives presented by the Academy of Accounting Historians. The original paper was presented at Drexel University, Philadelphia on 13 August 2000.

Key words: review engagements, auditor reviews, standard setting, interim reporting, interim financial information, moderate assurance, role of the auditor.

1 Introduction and motivation


Timely and reliable interim financial reporting improves the ability of investors, creditors and others to understand an enterprise's capacity to generate earnings and cash flows and its financial condition and liquidity. Because those primary users who find annual financial statements beneficial to their economic decisions, will also benefit from interim financial information, it could be argued that the same conditions indicating the need for an audit of annual financial statements are applicable in justifying independent auditor involvement with company interim reports (compare Jarnagin 1976:2,52,97; IASC 1996a:13; IASC 1996b, par. 23-42; IASC 1998, par. 8-19; SAICA 1998, par. .06-.08). However, as early as 1934 T.H. Sanders (1934:206-207) wrote: "It is not essential that these statements be audited, since apart from the expense, such a requirement would delay publication of the figures and thus materially reduce whatever value they might possess. Furthermore, the audited annual report will serve as a check on the quarterly reports." In 1965 in the United States of America (USA) R.G. Taylor (1965:89-96) again focussed attention on the need for an independent assessment of interim financial information by the external auditors. His arguments reflect the original need for the attest function as referred to above.

Today it is generally accepted that interim financial reports are mainly unaudited. When the external auditor is involved with a company's interim financial
information, more often than not because it is prescribed by statutory and/or regulatory requirements, this involvement takes the form of a review of the interim results (Edmonds 1983:429; Opong 1995:269; IASC 1996a:75-92; Gay, et al. 1998:472-475; Koen, et al. 1999:74-78). An auditor review aims to enhance credibility by way of the auditor expressing moderate assurance in respect of the reliability of the interim results in a written report (SAICA 1996:2).

Current requirements in South Africa regarding independent auditor involvement with interim financial information are contained in the Companies Act (1973, as amended), the Johannesburg Stock Exchange (JSE) Listing Requirements (JSE 1998) and professional auditing standards and guidelines issued by the South African Institute of Chartered Accountants (SAICA 1992, 1996). The current situation can be summarised as follows: When a listed 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 SAICA. It goes without saying that companies can also decide to voluntarily subject their interim financial information to auditor review.

The debate surrounding the issue of independent auditor involvement, however, is ongoing. Previous research and other applicable literature have identified important advantages and limitations of independent auditor involvement with interim financial information, including findings which contradict some of the stated advantages and suggestions that the need, nature and extent of such involvement have not been clearly established (compare amongst others Jarnagin 1976; Milburn 1980; Edmonds 1983; Borgia 1991; APB 1993; Gloeck and De Jager 1995; Opong 1995; Hasenfuss 1996; IASC 1996a; Gay, et al. 1998).

In South Africa, also, conflicting views have emerged regarding independent auditor involvement with company interim financial information. On the one hand the South African Shareholders' Association has strongly argued in favour of interim results being reviewed by external auditors, while on the other some fund managers have expressed doubts about whether a lack of audit review will negatively impact on investment decisions (Hasenfuss 1996). Furthermore, research has raised questions regarding the effective communication of the auditor's involvement to the users of interim reports, as well as the real contribution of such involvement to the financial reporting process (Gloeck and De Jager 1995; Koen, et al. 1997, 1998 and 1999).

This paper reports and analyses the history of the developments regarding independent auditor reviews of company interim financial reports in South Africa. The remainder of the paper is organised as follows: The next section formalises the research objective. Because auditing standard setting takes a central role in the historical developments, section three reflects on the standard setting process. Section five discusses factually the history of developments in South Africa and is preceded by section four which provides the international background in the context of which these developments took place. In section six the historical events/developments are interpreted and specific conclusions are reached regarding the standard setting process and implications for the auditing profession. The paper ends with a summary and suggestions for future research.

2 Research objective

An analysis of the literature referred to in section 1 indicates that specific practice has been established in respect of the independent auditor's involvement with company interim reports, namely to perform a review of the interim financial information, if and when required. It is, however, also clear that this remains a contentious issue that is periodically debated. In this context the following research objective applies to the current study:

To determine through examination of the history of developments regarding the auditor review of company interim financial information, the factors, issues and considerations which influenced current practice in South Africa and to identify the implications thereof for the auditing profession.

This would provide a theoretical base from which lessons can be taken for future developments in respect of the functions of the external auditor. As far as could be ascertained, no other South African study has documented and interpreted the developments relevant to the involvement of the auditor with company interim reports in this way. In fact, very little research in South Africa has been undertaken in this regard.

3 A perspective on the standard setting process

The auditing standard setting process is one of the self-regulation instruments of the auditing profession—a process various authors have argued is being misused by the standard setting bodies to exclude certain role-players in the accountability framework and to adopt strategies through which agendas reflecting the irrationality of certain groupings are being furthered (compare Parry and Parry 1977; Willmott 1986; Booth and Cocks 1990; Mitchell, et al. 1993; Willmott, et al. 1993; Gloeck and De Jager 1995 & 1999; Gloeck 1998a & 1998b).

Communicating auditor involvement with published information by way of including an auditor's report or otherwise stating the auditors involvement, legitimises somewhat the subject matter for the user thereof (Gloeck 1998b). Auditing standards shape both the work of the external auditor and the communication of his/her involvement with, and conclusion(s) about the subject matter. The acceptance of the standards and the standard setting process by all stakeholders is therefore essential to the justification of the auditor's functions (Puxty 1990; Gloeck 1998b). Persisting with a standard setting process which is perceived to be defective (excluding important stakeholders and advancing specific interests) would lead to auditing standards not being generally accepted by the users of auditing services and thereby undermining the functions of the external auditor (Ridings 1980; Puxty 1990;

As was stated in section 1, current South African practice with regard to auditor reviews of company interim financial information is prescribed by JSE regulations and professional standards and guidelines issued by the SAICA. The question arises: Has current practice in South Africa been adversely affected by a much criticised standard setting process? The remainder of the paper discusses this question and provides relevant information on this issue.

Research regarding standard setting in the accounting and auditing profession during the 1970’s and early 1980’s, already then identified key principles that need to be addressed by standard setting bodies in effecting acceptable and high quality standards (compare amongst others Burke 1978; Ridings 1980). These principles as they pertain to auditing standard setting can be summarised as follows:

- The standard setting body must maintain independence and objectivity in fact and appearance. Inadequately motivated decisions which advance the interests of certain groupings would impair the perception of independence and objectivity.
- Participation in the process by all the stakeholders affected or potentially affected by the standards are essential for the acceptance thereof. All stakeholders must be heard and their views considered.
- The quality of the standards must be enhanced by logical structure and argumentation, supported by fundamental reasoning and agreed-upon and socially acceptable objectives.
- Members of the auditing profession must support the standards in the execution of their functions.
- Research activities must provide the basis upon which sound standards and guidelines are developed.
- Standards must be administered in a responsible and systematic manner – enforcement of standards by the standard setting bodies.

In South Africa, Gloeck (1998b) has provided debate regarding the auditing standard setting process, including the identification of the factors which should characterise this process. Gloeck essentially encapsulates all of the key standard setting principles identified in the previous paragraph. These principles are therefore considered an appropriate context for the discussion of the historical developments of the auditor review of company interim financial information in South Africa.

4 International background

The developments in South Africa took place in the context of the international accounting and auditing profession. It is therefore appropriate to provide a brief background of international developments that should have influenced the development of South African practice regarding the external auditor’s involvement with interim financial information. It is important to note that the emphasis here is placed on international research regarding interim financial reports and the auditor’s involvement with these reports, and not on the detail development of specific professional standards in various countries.

From 1962 to 1966 there was an increased trend in the USA to more extensive publication of interim financial reports, together with the consideration of the role the external auditor should play regarding these reports (Taylor 1965). The early 1970’s and beyond were characterised by debate surrounding the issue of extension of the attest function to information other than reported annual results, the expression of different levels of assurance by auditors, the need for auditor involvement with interim financial information, the nature and extent of this involvement, professional standards for such engagements, etcetera (compare Carmichael 1974; Milburn 1980). In the wake of all these developments numerous research studies were undertaken. The results and conclusions of some of these are briefly referred to hereunder.

- Jarmanig (1976) reached the following conclusion in testing the hypothesis that attestation in the form of an auditor review adds credibility to interim financial statements: “... extension of the attest function to interim reports would not significantly increase their credibility ... Therefore, the move for limited review, or for attestation of interim financial statements, by public accountants may be inappropriate ...”.
- In 1980 Milburn conducted a comprehensive study on limited audit engagements commissioned by the Canadian Institute of Chartered Accountants (Milburn 1980). The study recognises that the review of interim financial information has become a useful extension of the auditor’s services. It is emphasised, however, that in developing review standards much more emphasis should be placed on the intended users of interim financial information: “It seems likely that the auditing profession will continue to have difficulty restricting expressions of limited assurance to particular specified users where the underlying information is relevant to a wider audience ...” (1980:89). Furthermore, both the development and the extension of auditor assurance services require careful evaluation by the profession.
- Edmonds (1983) examined the contention that an auditor review will improve the predictive content of interim data. He concludes that the empirical results do not support the stated contention. In fact, the results support a conclusion that the cost associated with an auditor review cannot be justified on the grounds that it will improve the predictive content of interim data.
- Brown, et al. (1993) report the existence of a “substantial expectation gap” regarding users’ perceptions of the differences between audit and review engagements, and the auditing profession’s view. It is suggested that the profession could possibly reappraise the audit and the review so as to bring the requirements thereof in line with users’ expectations.
- A project initiated by the IASC in November 1995 to develop an international standard on interim
financial reporting, identified key issues for consideration based on interim financial reporting research, including whether the IASC should “require or encourage independent auditor involvement with interim financial statements or selected interim financial data” (IASC 1996a). In September 1996 the IASC published a subsequent Draft Statement of Principles in which it proposes that there should be no requirement for any independent auditor involvement with interim financial reports. It recommends that “(this) is a matter for national securities legislation or regulation, stock exchange listing requirements, or professional standards. In many countries, national auditing standards will require inclusion of the auditor’s report if an auditor has been involved with an interim financial report.” (IASC 1996b:46).

- Gay, et al. (1998) found that auditors, company secretaries/accountants and shareholders all perceive that a review report communicates a lower level of assurance than an audit report. However, auditors’ beliefs in this regard were stronger than those of the other subject groups, and the clarity of the messages communicated was in doubt. This supports the existence of an expectation gap.

5 History of developments in South Africa

A factual discussion of the history of developments in South Africa surrounding the independent auditor’s involvement with company interim financial information would enable the identification of the factors, issues and considerations which influenced current South African practice.

The Companies Act in South Africa (1926 and 1973) has never required, and still does not require an audit or an audit review of company interim reports. Although the SAICA issued a pronouncement entitled Special reports expressing limited assurance (AU 333) in 1988, and revised it in 1992, the standard concerned addresses the acceptance and performance of engagements to express moderate assurance in a written report in general and does not deal with the review of interim financial information in particular (SAICA 1988, 1992). Auditing statement AU 333 still applies today as a South African auditing standard.

Discussion Paper 12, issued by the SAICA in March 1994, is deemed to be the first formal suggestion in South Africa of independent auditor involvement with interim financial information (SAICA 1994a; Koen, et al. 1997). The paper inter alia addresses issues relating to the role of the auditor, auditor independence, legal liability of auditors and audit committees. In respect of independent auditor involvement with interim financial information it states: “An additional problem is that users of financial statements often do not distinguish between audited and unaudited information contained in annual reports … It is therefore suggested that the auditor will need to review all financial information contained in annual reports and thus provide limited assurance as to the relevance and reliability of the entire range of information contained in annual reports and other public documents, such as interim reports and preliminary announcements issued by companies. … Auditors should carry out a review and give limited (moderate) assurance on all financial information contained in annual reports other than in financial statements and on other financial information (such as interim reports) issued by their clients.” (My insertions and emphasis.)

A total of 54 commentators responded to Discussion Paper 12 — 29 included comments that relate to the above recommendation regarding independent auditor reviews. 14 commentators (48%) expressed their support for SAICA’s recommendation, either unconditionally or conditionally, and 15 commentators (52%) rejected the recommendation, either unconditionally or conditionally (compare Gloeck and De Jager 1995).

The Expectation Gap Ad-Hoc Committee (supported by the Executive Committee of the SAICA) issued its recommendations arising out of Discussion Paper 12 in October 1994. These included that “(the Companies Act should be amended to require that interim reports should be subject to audit review and thus it would provide limited assurance. Before this can be put in place an accounting standard for interim reports should be issued.” (SAICA 1994b; SAICA 1995a).

The next relevant development can be traced to the issue of the King Report on Corporate Governance (King Report) on 29 November 1994. With regard to interim reporting the following comments and recommendations are made (King 1994:21,30): “Interim reports at present do not have to be reviewed or audited by the external auditors. We recommend that the external interim report should be subject to audit review. The audit committee report commenting on the interim report should be tabled at the board meeting. … The Companies Act should be amended to require that interim reports should be subject to audit review.” In April 1995, the SAICA publicly endorsed the recommendations made by the King Committee (SAICA 1995b).


In September 1995 Gloeck and De Jager issued a position paper dealing with the King Report. In this paper they argued that “the King Report’s recommendations with regard to the external audit function as an instrument to enhance good corporate governance, are deficient.” (Gloeck and De Jager 1995:1). They also rejected the King Report’s recommendation on the statutory auditor review of company interim reports because of reservations with regard to the process followed and the conclusions made by the King Committee, uncertainties regarding the role of the auditor in the context of socially acceptable objectives, as well as reservations regarding the auditing standard setting process.
The JSE reconsidered their position on the auditor review of interim reports in April 1996 (JSE 1996a). It is apparent from the relevant JSE Press Release that the reconsideration of the requirements concerned was primarily brought about by the comments and opinions of “senior executives of certain major listed companies”. The JSE also, for the first time, emphasised a specific distinction; that between a limited audit review and a full audit review. The definition of the difference between a limited review and a full review, however, is unclear and significantly did not appear in any of the professional pronouncements at the time (SAICA 1992; IFAC 1995). The JSE Listing Requirements were amended in August 1996 (JSE 1996b). In respect of auditor reviews of interim reports, unaudited interim reports are not required to be reviewed, except if the company's auditors have disclaimed their opinion or issued an adverse opinion on the company's latest annual financial statements. The requirements also clearly state that if a review is to be performed, it should be conducted in accordance with the guidelines issued by the SAICA. These amendments it would seem that the previously introduced (undefined) distinction between a limited audit review and a full audit review disappeared. At present these are still the applicable JSE requirements.

Also in August 1996 the SAICA published a document in its Corporate Governance Series entitled: Guidance for auditors — Review of interim financial information (SAICA 1996). It states that “(t)he objective of a review is to provide the auditor with a basis for reporting that nothing has come to his/her attention that causes the auditor to believe that the interim financial information needs modification so as to fairly present, in accordance with generally accepted accounting practice, the financial position of the entity at half year date and the results of its operations and cash flow information for the period then ended.”. The SAICA guidelines, supported by the JSE Listing Requirements, provide for two alternatives in respect of communicating the independent auditor’s involvement with company interim reports, namely to include the auditor’s review report as part of the interim report; or to include the interim report a public announcement regarding the review performed by the independent auditors.

Koen, et al. (1997) undertook a significant research project (the first of its kind) in South Africa in 1997. Their aim was to provide information pertaining to the extent to which South African companies adhere to statutory and regulatory disclosure requirements regarding interim financial reports, South African reporting trends in the context of international and local developments, as well as independent auditor involvement with interim financial information. A selection of 50 top listed industrial companies was utilised. These companies’ published interim reports were analysed against identified evaluation criteria representing specific disclosure requirements, disclosure practice and regulatory and professional reporting standards. They repeated their research project in 1998 and again in 1999, resulting in a series of three research reports on interim financial reporting in South Africa (Koen, et al. 1997, 1998, 1999). The following are their main findings regarding auditor reviews of company interim reports:

- The first research report (Koen, et al. 1997), pertaining to company interim reports issued during 1996 and early 1997, indicates that 21 (42%) of the 50 interim reports surveyed had been subjected to auditor review – 14 (28%) compulsory reviews and seven (14%) voluntary reviews, taking cognisance of changes to the JSE Listing Requirements in August 1996 (as discussed above). Nine of the 29 companies who did not indicate that their interim reports had been reviewed, were in contravention of the JSE Listing Requirements at the time (reports issued on or before 31 August 1996), which required that all listed companies’ interim reports had to be reviewed.

- In the second and third research reports (Koen, et al. 1998, 1999) the number of interim reports voluntarily subjected to auditor review increased to 9 (18%) and 11 (22%) respectively.

- Apart from one company in 1997 and 1998, all other companies chose not to include the auditor’s review report in their interim reports, but instead published a public auditor review announcement as part of the interim results. Regarding these reporting alternatives, the authors draw attention to major limitations of the public auditor review announcement. These relate to communication failures in respect of the addressee of the report, the purpose of the review, the information subjected to review, the directors’ responsibility, the auditor’s responsibility and the scope of the review (1997:98-101; 1998:89-92; 1999:86-89).

- In 1997 the average adherence to all the evaluation criteria pertaining to the public auditor review announcement (representing regulatory requirements and professional reporting standards) was 58%. In 1998 adherence rose to 60% and decreased again to 57% in 1999. It is significant that for all three years adherence to three reporting guidelines was zero. These three guidelines relate to stating which standards were applied in conducting the auditor review, explaining the objective of the review in terms of the assurance expressed by the auditors and contrasting review assurance (moderate assurance) to audit assurance (high assurance).

- The 1999 research report added the research proposition that because the auditors had to perform certain procedures in those cases where the interim reports were reviewed, those reports that had been reviewed would probably better adhere to the disclosure requirements than those that had not. The authors conclude “the interim reports that were not reviewed achieved a higher average percentage of adherence to disclosure requirements than those that were reviewed (79% compared to 75%) … the involvement of the auditor does not significantly impact on the degree to which interim reports are prepared in compliance with the disclosure requirements concerned. This raises an important question with regard to the relevance of independent auditor involvement with interim financial information.” (1999:106-110).
6 Interpretation of historical developments and conclusions

The previous section set out the relevant events/developments regarding auditor reviews of company interim reports in South Africa. In this section these developments are interpreted and appropriate conclusions drawn.

Two separate periods of events/developments can be distinguished: (1) Developments up to 1996 when the JSE Listing Requirements were finally amended and the SAICA issued a pronouncement entitled Guidance for auditors: Review of interim financial information, which established the requirements and standards still applicable today. (2) Developments since 1996 which reflect on how the established requirements and standards are being applied in practice.

6.1 Developments up to 1996

The factors, issues and considerations which influenced the developments up to 1996 can be summarised as follows (A to D).

A) A discussion paper and the comments it elicited, issued by the SAICA (standard setting body)

There are some aspects which cast serious doubts over the recommendations that resulted from the above process:

- Originally the focus was on auditor reviews in general, without emphasising the reviews of interim reports. The final recommendation, however, only addresses independent auditor reviews of company interim reports.
- From the comments received it is clear that there was by no means majority support for an independent review of interim reports; in actual fact the majority (52%) rejected the SAICA's original recommendation.
- Prior to the final recommendations, there were no indications of any statutory reviews being considered or under discussion.

B) Recommendations of The King Report on corporate governance in South Africa

The recommendations regarding the requirement of an auditor review of external interim reports were fundamentally criticised, based on the auditor's social accountability function and a deficient standard setting process. Furthermore, three of the five members of the King Committee's Audit Task Group also served on the SAICA's Expectation Gap Ad-Hoc Committee which affected the recommendations in A, above (compare Gloeck and De Jager 1995).

C) Research in respect of corporate governance principles and the role of the auditor

Although discussing the extent of the research's influence would be speculation, the timing of the particular research (Gloeck and De Jager 1995) and that of the JSE regulations amendments (JSE 1996a, 1996b), warrant a conclusion that it probably played some role in the changes.

D) The views of stakeholders directly affected by the regulations

Stakeholders affected by the new JSE regulations drew attention to concerns regarding the “value for money” and the inherent value of independent auditor reviews of interim financial reports. At this stage, these and related concerns had already been indicated by both international and South African research.

The final result

The JSE Listing Requirements were finally amended in August 1996. Initially auditor reviews of listed companies’ interim reports were made compulsory. This obviously happened under the influence of the factors discussed in A and B. Within 14 months the requirements were amended to only require reviews in certain instances. These amendments took place amid the developments in C and D. The amendments, to say the least, were an artificial attempt to retain the compulsory auditor review in certain instances: Justifying it by referring to an undefined, and previously unarticulated, distinction between a so-called limited audit review and full audit review – a distinction which disappeared completely after the amendments.

The SAICA (the standard setting body) also issued its final guidelines in August 1996. The guidelines, in essence, are in line with the requirements of the JSE. This is not surprising, because it is clear that the SAICA and the JSE worked together in finalising the requirements and the professional guidelines (refer to JSE 1996a). The SAICA guidelines were compiled from the King report and the professional standards of other international standard setting bodies (SAICA 1996:30). This amid the criticism of the King Report and of the standard setting process internationally.

Regarding reporting guidelines in particular, two issues are worth discussing. The choice to either include the auditor's review report as part of the interim report, or to include a public auditor review announcement is in contrast with observed international trends and resultant recommendations (ASIC 1996b). Subsequent research in South Africa (Koen, et al. 1997, 1998 and 1999) also points to fundamental deficiencies of the public auditor review announcement. Secondly, the guidelines provide that if the auditor's review report is included in the interim report it should be addressed to the shareholders, but if it is not included, it should be addressed to the directors. Restricting the expression of assurance in this instance is normatively unacceptable in the context of the “intended user” concept (compare Milburn 1980; Koen, et al. 1997, 1998 and 1999).

The final JSE regulations and SAICA guidelines seemingly also ignore the following issues highlighted by international research:

- Empirical results question the ability of auditor reviews (as being applied) to make a significant contribution to increase the credibility of interim financial information.
Although the review engagement is a logical extension of the external auditor’s functions, care should be taken in developing socially acceptable standards. This is especially relevant since interim financial information is intended for a wider audience than the company alone.

The cost of auditor reviews is not justifiable on the grounds that it will increase the predictive content of interim financial information. This again implies the lack of an increase in the credibility of such information.

Users expectations with regard to distinguishing an auditor review from a normal financial statements audit are not being met. Evidence of an expectation gap exists.

6.2 Developments since 1996

Since the finalisation of the JSE Listing Requirements and the SAICA guidelines in 1996, the following primary observations, supported by empirical research, are possible (A to C hereunder). These represent the development of related practice in South Africa within the framework provided by the JSE regulations and professional standards.

A) Evidence exists that listed industrial companies reject, through their practice, the regulations and standards

A substantial part of listed industrial companies (39% of companies surveyed) contravened the June 1995 JSE regulations by not subjecting their interim results to auditor review (or at least, their interim reports did not indicate that they had been subjected to auditor review).

Although up to 22% of companies surveyed voluntarily subjected their interim results to auditor review, there is no indication of general acceptance of the principle that an auditor review offers value in terms of enhancing the credibility of the interim financial information.

Adherence by listed industrial companies to the SAICA reporting guidelines (the only formal guidelines in South Africa) in respect of the public auditor review announcement included in the interim report, stabilised around 58%. Key omissions in the communication to the users of the interim results deny them vital information pertaining to the quality of the review (adherence to established standards), the objective of the review, the nature and extent of the procedures performed and the level of assurance provided by the auditor.

Although it might be argued that the above all represent actions of the companies and not of the auditors, it is important to remember that the auditors have an important role to play in assuring compliance with applicable regulations and standards, and advising their clients accordingly.

B) Deficient reporting practice has been established

When reviews are conducted, companies (and their auditors) primarily opt to include in the interim report a public auditor review announcement, instead of publishing the auditor’s review report with the interim results. The auditor’s involvement is therefore communicated via a deficient reporting vehicle (as discussed earlier), thereby enhancing the user expectation gap. This is further emphasised by the lack of adherence to reporting standards, as discussed in A above.

C) Auditor reviews do not impact on the degree to which interim reports are prepared in compliance with statutory and regulatory disclosure requirements

This raises an important question with regard to the relevance of such reviews to the financial reporting process, involving all the intended users of interim reports. Credibility is not enhanced if auditor involvement cannot even provide assurance with regard to this most visible aspect of the interim report, namely the disclosures contained therein. Users might have certain expectations in this regard and therefore in the end misinterpret the auditor’s involvement.

6.3 Conclusions

The history of the developments of auditor reviews of company interim financial information in South Africa, as documented and interpreted in this paper, reflects on the standard setting process. With regard to the key principles of sound standard setting identified in section 3, the following applies:

- The SAICA and the JSE did not maintain their objectivity in fact and appearance. They consciously advanced a specific viewpoint regarding independent auditor reviews, despite fundamental criticism from international and local research, as well as the opinions of stakeholders directly affected by the regulations and guidelines. Although some attempt was made to incorporate the latter, the end product is still normatively not acceptable.
- It is doubtful whether all the stakeholders affected or potentially affected by the relevant standards were heard and their views considered. In fact, when comments were invited on one relevant discussion paper, the majority view was rejected. The final SAICA pronouncement (SAICA 1996) was not the result of an open and public consultative process.
- The quality of the professional guidelines developed (SAICA 1996) are not supported by fundamental reasoning and agreed-upon and socially acceptable objectives. The reporting guidelines in particular are in contrast with fundamental reporting principles, and the availability of a normatively deficient reporting alternative accentuates the existence of an auditor-user expectation gap.
- There is evidence that members of the auditing profession do not support the standards in the execution of their functions, whether directly or indirectly. Some reporting guidelines are not complied with and the auditor review does not assure the interim report’s preparation in compliance with relevant disclosure requirements.
• Research obviously did not provide the basis upon which the professional guidelines were developed. In some instances the guidelines are in contrast with and/or did not take cognisance of relevant research findings. The SAICA pronouncement also does not refer to any significant research from which it was compiled.
• After three research reports in South Africa, covering three consecutive years (1996/1997 to 1998/1999), fundamental criticism regarding various reporting practices and the non-adherence to professional guidelines have in the main been ignored by the standard setting bodies. There is no visible evidence of enforcement of standards.

The implications of these observations for the auditing profession in South Africa is far reaching, but can best be summarised as follows: Until the auditing profession, and the standard setting bodies in particular, take seriously the fact that the auditor fulfils his/her functions within a social accountability framework, and take cognisance of and apply the principles of sound, socially acceptable standard setting, supported by open, transparent and all inclusive processes, we will continue to have a situation of deficient professional standards that are being rejected by the users of auditing services and indeed members of the profession themselves, resulting in the marginalisation of the role and functions of the external auditor.

7 Summary

It is generally accepted that company interim financial reports communicate decision useful information to various stakeholders. The debate of whether independent auditor involvement with interim financial information can, and does make a relevant contribution to the financial reporting process is an old, contentious and continuous one, as history has shown.

In South Africa, also, the auditor review of company interim reports has undergone major developments and change. When seen in the context of the standard setting process the developments have important implications for the auditing profession. The objective of the current study was to determine through examination of the history of developments regarding the auditor review of interim financial information, the factors, issues and considerations which influenced current South African practice and to identify the implications thereof for the auditing profession.

Relevant factors, issues and considerations were identified by way of analysis and interpretation of the history of the events which resulted in current South African regulations and professional guidelines, and which reflect on the application thereof. Evidence exists that present practice in respect of auditor reviews of company interim financial information resulted from a deficient standard setting process which in the main fails to recognise and implement the defined principles of sound and socially acceptable standard setting. The auditing profession’s ignorance of these principles will continue to foster deficient standards – rejected by the users of auditing services and resulting in the marginalisation of the role and functions of the external auditor.

Future research is required in various related areas. Similar studies performed in other countries can contribute to the global perspective regarding auditor reviews of interim financial information. Other discursive studies focussing on the history of developments in respect of various functions and duties of the external auditor would provide valuable and additional insight into both the auditing standard setting process, as well as the evolution of the auditor’s functions. Regarding the standard setting process in particular, future research should focus on revealing current strategies and policies inherent in the standard setting process, identifying and implementing strategies to establish an inclusive democratic process, and re-evaluating the current professional standards which are the results of a process perceived to be defective.

References


Auditor reviews of interim financial information in South Africa


