

CHAPTER 10

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

10.1 Introduction

This dissertation tested explicitly the extent of voluntary disclosed items in annual reports of quoted South African companies and the informational importance of voluntary disclosure to market constituents and its association with share prices. Disclosure problems result from a lack of quality and poor context and not from limited quantity of information. Groves (1994:11) projected from a non-scientific survey of the 1972, 1982 and 1992 annual reports of 25 large well-known companies that the average number of pages in the annual report, including the footnotes and the management discussion and analysis, would amount to 146 pages in the year 2002 and 237 pages in the year 2012. However, Paradigm Interactive Media Limited, whose 1998 annual report consisted of 80 pages, anticipates that “within ten years the paper-based annual report will no longer exist and that the move towards the coding of data in an electronic format allows for complete interactivity, with the senses of hearing and sight being employed to bring the user a complete experience of a company’s values, vision and performance in an ever-evolving market place” (1998: inside cover).

Ultimately, to avoid financial disclosure overload in the future, it may be necessary to publish separate, supplementary or summarised reports to serve the various needs of the different stakeholders. This problem may be solved by the use of publicly accessible databases such as the Securities and Exchange Commission’s electronic data gathering and retrieval system and Compustat. These systems which are aiding the globalisation of financial markets, should also contribute towards greater conformity with regard to both mandatory and voluntary disclosure items. Wallman’s solution (1997:110) to the problem of information overload is a user customised system where the users determine what information they wish to access from a comprehensive disaggregated database,

to enable them to prepare their own customised financial statements from real-time information. Such a solution would provide enormous cost savings for corporations as the publication of an annual report is a costly annual exercise. A second advantage is that such a real-time access data system would aid the investors' decision making because it would decrease uncertainty and price volatility. On the other hand, such a system would provide competitors with valuable information, although this danger may be prevented by limiting in-depth access to large and important investors. Electronic data will certainly be the primary source of information in the future and annual reports should already be geared to this method of disseminating information.

However, the financial reporting milieu does still need to address international issues on how financial data is to be disseminated globally. Extending reporting regulations is not the solution to closing the "communication gap". Rather, the solution lies in focusing on an improvement of the corporate disclosure process.

10.2 Reiteration of the purpose of the research

The research involved both a review of the relevant literature and an empirical investigation. In the literature review the theoretical background of voluntary disclosure and the prior research conducted on this subject was taken into consideration. The empirical investigation was aided at determining the extent of voluntary disclosure and the perception consensus of compilers and users with regard to the price informative value of voluntary disclosure. Before making recommendations based on the results of this study, a short overview of the goals and hypotheses of the research will be provided.

In view of the fact that no significant perception differences could be found between compilers and users in the case of two thirds of the voluntary disclosed items, the conclusion may be drawn that the level of consensus indicates a high degree of validity for the research findings.

10.3 Recommendations for future research

10.3.2 Operating and financial review statements or management's

Even if they are provided voluntarily, disclosures should be reliable, consistent and improve the quality of corporate communication. Furthermore, the interest of the users of corporate annual reports should take precedence over the interests of compilers. Therefore, recommendations for future research centre around the following topics:

10.3.2.1 Recommendations for an operating and financial review that could also be

- a code of ethics;
- operating and financial review statements or management's discussion and analysis reports;
- productivity statements;
- incentive schemes;
- adherence to international accounting standards;
- environmental awareness and conservation;
- price sensitive information;
- intangible assets; and
- websites.

10.3.3 The relationship between budgets and credited sales

10.3.1 A code of ethics

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An international code of ethics should be adopted to serve as a basis for developing any particular country's own code in which the specific needs of that country and its cultures and traditions are taken into account. Such a code of ethics should be enforceable by law and applicable to all individuals so as to limit fraudulent practices and encourage efficiency and competence. Management should consistently review its ethical accounting practices and social policies and ensure that they are implemented throughout the organisation.

10.3.3 Productivity statements

Productivity accounting as defined by Hobbs (1994:1) in a paper delivered at the 1994 South African Financial Controllers congress, is the relationship between output quality and input quantity. For an economy to survive and be competitive locally and internationally, efficient, effective and economic utilisation of all resources, namely

10.3.2 Operating and financial review statements or management's discussion and analysis reports

To encourage companies to publish a management's discussion and analysis report, the Accounting Standards Board published a discussion paper in April 1992 which contained guidelines for an operating and financial review that could be included in annual reports of companies. In this review management would discuss the main factors underlying the trends and changes in the performance and financial position of the corporation. At the same time, the Securities and Exchange Commission in the USA and the Ontario Securities Commission in Canada made it a requirement that all listed companies in their jurisdictions file a management's discussion and analysis report. Companies in the United Kingdom must also include an operating and financial review report.

In such a statement or report, management could articulate areas of importance to users such as strengths and weaknesses, risks and opportunities, proposed long-term strategies, comparisons between budgeted and projected performance and actual performance, future dividend policy, forecasted profits and earnings per share and analyses of capital resources, expenditure and liquidity. Negash (1999:2) identifies a variety of risk factors such as market, leverage, operating, interest rate, currency, information and measurement risk and more emphasis should be placed on the development of alternative methods of accounting for and disclosing risk. Some companies are already doing so, and in its 1997 annual report Iscor Ltd (1997:73), for example discussed risk management relating to treasury, foreign currency, interest rate, liquidity and credit risk.

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manpower, materials and capital, is required. Therefore the productivity performance of an organisation should be measured and quantified and targets for productivity improvements should be set and built into the overall budget. Any productivity saving should be passed on to the employees in the form of bonuses.

Presently there is no legislation in South Africa on productivity accounting although various guidelines and recommendations exist. At the moment, productivity accounting is very limited and commonly restricted to reporting sales per employee. More research should accordingly be conducted on productivity accounting and its methodology, the end goal being to promote its use and disclosure by corporations in South Africa. Productivity statements should form part of the annual report and disclosure should be governed by accounting standards laid down by the South African Institute of Chartered Accountants together with the National Productivity Institute.

10.3.4 Incentive schemes

Performance based executive compensation schemes should be linked to a reliable measure of managerial progress in creating shareholder wealth. A proposal of the Jenkins Report is that companies should disclose management performance measures that are used to reward directors and management such as profit sharing and incentive schemes (Ansari & Euske 1995:40). Measures used to evaluate managers' performance are profits, turnover, valued added and accounting ratios such as earnings per share and return on equity and assets.

Financial measures are often poor indicators of the creation of shareholder wealth as they can be manipulated to the detriment of the interest of shareholders. Therefore a financial performance measure such as economic value added (EVA) should be employed as the basis for determining bonuses or remuneration. EVA has proved to be one of the best measures of performance as it is directly linked to the wealth created for shareholders.

Share options, bonus schemes and performance-based share option schemes are

based on the principle that managers have the right to purchase shares at a discounted price over a period of time. As a further incentive the purchase transaction is often financed by the entity at a low interest rate. The success of these schemes are dependent on various factors that are difficult to control, such as the state of the economy, politics, bank interest rates and stock exchange performance. Incentive schemes also help to harmonise the actions of management with the goals of shareholders.

10.3.5 Adherence to international accounting standards

In the light of the greater capital market globalisation and conflicting accounting standards between countries, South African companies should be adopting or applying international accounting standards or basing their own standards on them in order to attract international investors. South Africa has now complied with 38 of the 40 international accountancy standards. Six new standards which were introduced in 1999 and came into effect on 1 January 2000 has had the effects of

- changing the method of reporting and amortising goodwill;
- discouraging companies from disguising excess profits in the form of provisions to smooth out future earnings;
- fundamentally changing the definition of a “subsidiary company” in the consolidation of accounts;
- only allowing the recognition of intangible assets if very strict criteria are met;
- clarifying the disclosure requirements of discontinuing operations; and
- tightening up the impairment of assets.

In discussing what the Financial Accounting Standards Board would like to achieve in the year 2002, Beresford (1996:6) identified four strategic directions, namely to

- build broader acceptance of the FASB and its process among constituents;
- make standard setting more timely and efficient;
- enhance the financial reporting model; and
- promote the development of superior international accounting standards.

10.3.6 Environmental awareness and conservation

As a dedicated environmentalist, Dr Hanks believes that environmental conservation is an essential prerequisite for sustained economic growth and furthermore that impoverished and overcrowded rural communities have no alternative but to degrade and eventually destroy the common property resource base on which their survival depends (Hanks 1996:3). With the population of the world possibly doubling during the next decade, corporations and individuals must focus on the preservation of their country's natural resources and if necessary make environmental reporting compulsory. In his concluding chapter of his dissertation De Villiers (1996:202) suggests the following minimum requirements for corporate environmental reporting:

- a descriptive overview of the major environmental risks and their impact on the organisation;
- the environmental policy of the organisation;
- targets measurable in physical units and rand amounts regarding for example emissions on which the environmental policy is based;
- performance against environmental targets and comparative figures;
- accounting policies for the recording of liabilities, provisions, contingent liabilities and catastrophe reserves;
- environmental costs relating to factors such as energy, waste handling, treatment and disposal, legal compliance, packaging, fines, rehabilitation and recycling should be disclosed by category and charged to operating expenses during the period;
- rand amounts of environmental liabilities, contingent liabilities and reserves established during the current period;
- government environmental grants received;
- likely effect of environmental policy on future capital investment and earnings;
- environmental litigation the organisation is currently involved in; and
- independent third party attestation of all environmental reporting.

The fact that both users and compilers indicated that environmental information in annual reports was important, necessitates direction in this area from the government and accounting bodies, and guidelines for disclosure are essential. Efficient environmental stewardship is critical in Africa particularly in view of the world's highest fertility and birth rate.

10.3.7 Price sensitive information

The policy that companies should adopt in dealing with price-sensitive information should be in accordance with the guidelines of the Johannesburg Stock Exchange. A company should follow a principle of a "closed period" during which employees and directors are prohibited from dealing in the company's shares and, in order to preserve the confidentiality of price-sensitive information, management should not be allowed to hold discussions regarding the company's performance with analysts, institutional investors, the media or any other persons who may gain unfair advantage from such discussions.

10.3.8 Intangible assets

Knowledge and innovation, or so-called intellectual capital or soft assets, form an integral part of corporate value and its disclosure in corporate reports is an area of great concern. Intellectual property may be regarded as knowledge used by a business entity to operate effectively and is essential to sustain it as a going concern. However, if intellectual property is viewed as an asset, what are the recognition and measurement criteria and how should it be disclosed? Particularly in the case of industries dependent on intellectual property, such as service industries, banks, insurance companies, brokers, accounting firms, medical practitioners and communication providers, lack of recognition will result in their annual reports being unrealistic, as a result of one of their most important assets not being omitted in measurable terms at all.

10.3.9 Websites

REFERENCES

Accounting Education Research Committee, 1975. The Corporate Report, London: ACCA.

Many companies worldwide are now making use of websites on the internet, in an effort to narrow the communication gap that exists between companies and investors. However, there are numerous disadvantages to be overcome such as high cost, computer security issues and legal problems arising from the fact that some investors have access to web browsers but others do not. However, given the tremendous advantages of computerised data access, websites at present seem to offer one of the most viable ways of ensuring that data reaches users. As in the case of formal, published reports, the site should offer information on at least the following aspects to ensure that it meets user needs: a summary of the company's latest annual report; a data bank of press releases and announcements; information on the company's products and services; on-line share prices; graphical displays; and contact numbers.

10.4 Conclusion

Most annual reports disclose the effects of past events and therefore meet the general needs that most users have in common. However, not all disclose additional voluntary information such as the future-oriented information required to make informed economic decisions. Areas of disclosure to which corporations need to pay more attention are:

- extending disclosure of business segment information;
- improving disclosure of off-balance sheet financing arrangements;
- reporting the effects of core and non-core activities separately;
- reporting the fair value of non-core assets and liabilities; and
- improving disclosure about the uncertain measurement of some types of assets and liabilities (Eccles & Mavrinac 1995:17).