Interim Financial Reporting:

A survey of Indian practice

Interim Financial Report is a report containing either a complete set of financial statements or a set of condensed financial statements for an interim period. This article attempts to find out the issues on which Indian accounting standard on IFR agrees or disagrees with clause 41 of the listing agreement.

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Interim Financial Reporting (IFR) began in 1902 with the United States Steel Corporation becoming the first corporation in the country to publish quarterly financial information.

Interim statements are designed to provide a timely reporting of pertinent financial information with highlights of significant happenings. The report is intended to assist the investors and other users in foreseeing the performance trend of the business. With the passage of time and increasing volatility of the market 'more information faster' is the watchword of today. Annual statements in comparison, complete in information content take more time to disclose them. Hence, interim results get more importance than results at the year-end. However, Interim Financial Report (IFR) and Interim Financial Results (IFRs) are not the same.

Interim financial report is a report containing either a complete set of financial statements or a set of condensed financial statements for an interim period. A set of financial statements normally comprises balance sheet, statement of profit and loss, cash flow statement, and selected explanatory notes. Accounting standards on this subject (e.g., AS 25 of India, IAS 34) requires publication of IFR. Interim Financial Results (IFRs) is not clearly defined by the Indian standard (AS 25), but is deemed to mean quarterly profit and loss statement.

In India, Interim Financial Results are prepared and presented by the listed companies in compliance with the requirement of the listing agreement. In India, the Securities & Exchange Board of India (SEBI), the securities regulator, has directed stock exchanges to secure that companies listed on them comply with relevant clause of the Listing agreement (viz. clause 41) in preparation and presentation of interim financial results.

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Conceptual Issues

Early release, rather than release at the year-end, of interim results restricts the quality of measurement because of immature information associated with estimation at higher cost. However, for enterprises, which require or elect to present IFRs, the recognition and measurement principles contained in accounting standard (AS 25) on IFR are relevant as they provide guidance for preparation of such results. The standard provides that:

i. An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements.

ii. Any change in accounting policy made after the date of most recent annual financial statements should be reflected in the next annual financial statements.

iii. An enterprise should report interim results on year to date basis so as not to affect the measurement of its annual results. Year to date measurements involves changes in estimates of amounts reported in prior interim period of the current financial year.

However, in case any change in estimate of amounts is effected prior to final interim period and no separate final report is prepared for that final interim period, the change in estimate should be disclosed in a note to annual financial statements, and for a change in accounting policy other than one for which the transaction is specified by the accounting standard, should be reflected by restating the financial statements of prior interim periods of the current financial year. But the principles for recognizing assets, liabilities, income and expenses for interim periods are the same as that of annual financial statements.

One more important issue regarding measurement principles to be adopted in preparing interim financial statements is whether the interim period is a part of a larger period or a period in itself. There are two views, Integral view and Discrete view. According to Integral view, interim period is a part of a larger period and is based on estimates of total annual revenue and expenses. The Discrete view holds that earnings for each period are not affected by projections of the annual results and the methods used to measure earnings are the same for any period whether a quarter or a year. The difference between two approaches may be drawn with respect to fixed cost. Under Discrete approach fixed cost is recognized in each quarter as it is incurred. Where as fixed cost in Integral approach is recognized in each quarter on the basis of contribution or some other reasonable basis and is deferred to the next quarter by the amount by which the actual amount incurred exceeds the recognized amount. As a practical approach, some elements of both the approaches are recognized in reporting requirement prescribed by AS 25. As regards components of interim statements, AS 25 does not require preparing 'Change in Equity Statement' which is a part of IAS 34.

Seasonal business has also raised questions about matching revenue and expenses during the year. When revenues are confined to a shorter period and direct costs are incurred throughout the year, is it appropriate to spread these costs proportionate to revenues? Or should there be smoothing of revenues and expenses over the year as a whole? In this regard AS 25 provides that revenues that are received seasonally or occasionally within a financial year or costs that are incurred unevenly during an enterprise's financial year should be anticipated or deferred as of an interim date if anticipation or deferral would be appropriate at the end of enterprise's financial year.

Estimates and judgments are required to determine results of operation for any periods, even a whole

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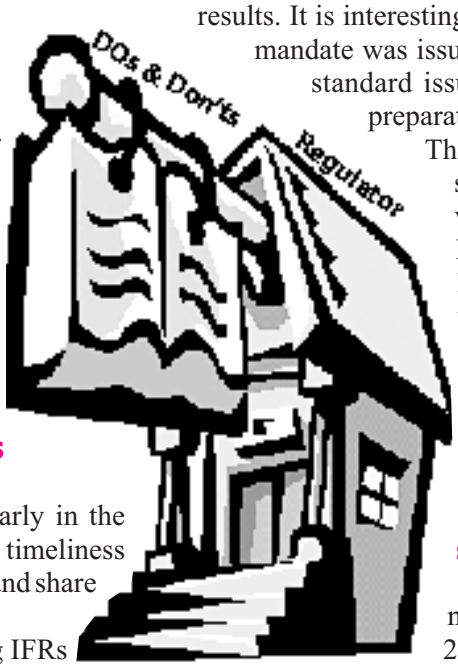
year. Normally, though the shorter the periods, the less precise the results, because the relative importance of estimates and judgments increase as the materiality base, viz., the reported amounts decrease. Further to speed up the release of interim results, companies must rely more heavily on estimates. The task is definitely complex, costly, and time consuming too. Of course, the more sophisticated a company's accounting system and the stronger its internal control, the less it needs to rely on estimates (Vanpelt III, 1976.). Investors have a tendency to project full year's results on the basis of data given for shorter periods.



Regulatory Requirements

Public disclosure of information, particularly in the interim period, needs to be regulated for its timeliness of presentation and for forecasting earning and share prices.

In India, the requirement of publishing IFRs was, for the first time, introduced by way of publication of unaudited half-yearly results through amendments in Clause 41 of the listing agreement w.e.f March 1988 vide Ministry of Finance, Department of Economic Affairs, Stock Exchange Division letter no F14/2/SE/85-pt dated 9.12.1987. After a decade it was modified, incorporating publication of unaudited quarterly results with effect from June 1998 vide SEBI letter no SMD/POLICY/CIR-12/98 dated 7.4.98. The SEBI has the power to direct all recognized stock exchanges requiring change in any clause of listing agreement. Listing agreement is the standard agreement entered into between the company seeking listing and the stock exchange where listing is sought. Any stock exchange has the power to alter the clauses of the agreement unilaterally and companies listed with that exchange are bound to accept such change to enjoy the facility of listing (Dhar, 2001).

It is considered that the listing agreement is the most influential aspect of stock exchange regulation as far as financial reporting is concerned (Chakraborty, 1994). The SEBI has used this vehicle to make certain important reforms in the field of corporate financial reporting e.g. requirement to prepare and publish interim financial results, limited review of interim results by the auditor, etc. As per the SEBI mandate introduced through Clause 41 of the listing agreement w.e.f. the quarter ending on June 1998, all listed companies are required to publish quarterly financial results. It is interesting to note that when the SEBI mandate was issued, there was no accounting standard issued by the ICAI as regards preparation and presentation of IFR. The ICAI has issued accounting standard (AS 25) on IFR w.e.f. April 1, 2002. However, the SEBI has since long been on the revision of the guidelines from time to time to make IFRs more user friendly.

The Clause 41, which covers substantial part of the quarterly reporting, holds the following important provisions (Ramaiya, 2003).

(i) The listed companies will on or after March 31, 2000 furnish unaudited quarterly results in the prescribed proforma within one month from the end of the quarter to the stock exchanges on which it is listed and will publish the same within 48 hours of the conclusion of the board meeting in at least one national newspaper and one regional language newspaper.

(ii) The half-yearly results shall be prepared on the same proforma with effect from March 31, 2000 and should be approved by the Board of Directors (BOD) and reviewed by the auditors of the company (or by any chartered accountant in case of public sectors undertakings) with effect from that date.

A copy of the review report shall be submitted to the stock exchange within two months after the close of the half-year. If the company intimates in advance to

the stock exchange that it will publish audited half-yearly results within two months after the half-year and/or that it will publish audited results within a period of three months after the last quarter, the unaudited results need not be published. Recently, limited review has been introduced for quarterly results w.e.f. quarter ended June 2003 and the review report is required to be submitted with the stock exchange concerned within two months of the end of the quarter (SMD/POLICY/CIR-2/2003dt 10.01.2003).

(iii) For the listed companies, the quarterly results shall be prepared on the basis of accrual accounting policy and in accordance with uniform accounting practices for all periods on quarterly basis. It will incorporate a statement of segment-wise revenue, results and capital employed prepared as per AS 17 on Segment Reporting and will also comply with AS 22 on Accounting for Taxes on Income as regards measurement of the requirements of deferred taxes.

(iv) The companies will have the option to publish consolidated quarterly results in addition to unaudited quarterly results of the parent company.

(v) In case a company has changed its name along with new line of business after 1st January 1998, it will disclose the turnover and income, etc. from such new activities separately in the quarterly results for a period of three years from the date of change of name.

(vi) If the sum total of the Q1 (1st quarter), Q2 (2nd quarter), Q3 (3rd quarter) and Q4 (4th quarter) results in respect of any item given in the Proforma IFRs varies by 20% when compared with audited results for the full year, the company shall explain the reason of such variation to the concerned stock exchanges. In case of half-yearly results, if the sum total of Q1 and Q2 in respect of any item given varies by 20% or more for the respective half yearly results as determined after the limited review, the company shall send a statement approved by BOD explaining the reasons to the stock exchanges along with review report.

(vii) Where the auditor has qualified the accounts of the previous accounting year and if such qualifications may materially impact the current quarterly result, the company should disclose the same with explanatory statement.

As a practical approach some elements of both the approaches -- Integral approach and Discrete approach -- are recognized in reporting requirement prescribed by AS 25. As regards components of interim statements, AS 25 does not require preparing 'Change in Equity Statement' which is a part of IAS 34.

(viii) The effect of changes in the composition of the company during the quarter, including the business combination, acquisition or disposal of subsidiaries and long-term investments, restructuring and discontinuing operations shall be disclosed.

(ix) It is also required to disclose the position of Investors' complaints.

At present, in India enterprises are not under any statutory requirement to present IFR within the meaning of AS 25. Therefore, no enterprise in India is needs to comply with disclosure and presentation requirement of AS 25 unless it voluntarily presents IFR within the meaning of AS 25. According to ICAI, only recognition and measurement principles contained in AS 25 are applicable for preparation of quarterly results by the listed companies. It is not clear whether the requirement of AS 25 applies to quarterly results because Clause 50 of listing agreement again requires the listed companies to comply with all the accounting standards issued by ICAI.

Survey of Indian Practice

The main objective of the present survey is to assess the practice of reporting interim financial results in India and to discover therefrom the area of diversity and the causes thereof, the extent of compliance with SEBI guidelines. Quarterly results of 50 companies for the period ended 30-09-02 have been examined for the purpose. It is also attempted to find out whether there could be any significant improvement in IFRs reporting in India in line with the requirement of AS 25.

Selection of Samples and Methodology

For the purpose of the survey, 50 companies have been taken in the sample on the basis of availability of interim financial results. It may be termed as convenience sample. However, it is considered adequate for our purpose. The classification of companies surveyed are shown in Table1

Table 1: ***Classification of Sample Companies***

Particular	No of Cos
Multinationals	06
Public sector undertakings	05
Financial Institutions, Banks	07
Other manufacturing cos.	32
Total	50

(Source: Unaudited results of sample companies. Results computed)

The survey procedures include close scrutiny of IFRs prepared by sample companies and reporting pattern of IFRs in the unaudited/audited published results to find out the techniques underlying the preparation of IFRs in India and the position of compliance with relevant guidelines.

Survey Results

We have considered certain aspects of disclosure and compliance to find out areas of diversity and to suggest improvement in IFRs. The issues are selected from the viewpoint of timeliness and quality of disclosure. The results of the survey are as under:

i. Format of reporting

At present, there is no prescribed format for preparation of profit and loss account under the Companies Act, which requires disclosure of certain items only. The SEBI in Clause 41 of listing agreement has prescribed formats for presentation of quarterly financial results. There are two formats for presentation of quarterly results that are classified on the basis of classification of expenditures. The 'General' format requires classification of itemwise expenditures. The 'Alternative' format exhibits functionwise classification of expenditures (viz., administrative, selling and distribution expenses etc). A company may follow 'General' format. But Clause 41 provides that manufacturing and trading/service companies, which have followed functional classification of expenditure in the annual profit and loss account in their most recent annual report, may furnish results in this 'Alternative' format. Now, the problem with reporting of itemwise classification of income and expenditure in the General format is that the total profit/loss after interest and depreciation earned as a result of difference between total revenue and total expenditure does not make a difference between operating and non operating profit /loss. Thus, the General format does not show operating profit/loss separately wherefrom an idea of operating efficiency of the business can be obtained. On the other hand, the Alternative format provides a separate display of items, a company's activities such as selling products (revenues), incurring cost directly related to those sales (cost of sales), and incurring expenses that generally support the business (selling, general and administrative expenses). All these are to give operating profit before interest and depreciation. After deducting depreciation and interest therefrom, the net is operating profit after interest and depreciation. Thus, the Alternative format gives a vivid picture of operating efficiency of the business. Clause 41 prescribes another format also for segment information, which requires to be disclosed along with audited/unaudited quarterly financial results.

Regarding choice of format for presentation of IFRs, our survey results show that 43 companies have presented their quarterly results in the General format and 6 companies in the Alternative format and only 1 company has its quarterly results without following any one of the two formats in entirety. So, majority of the companies have presented their quarterly results in the General format. *It may be suggested that it would be more informative if itemwise expenses were disclosed under their respective functional heads.*

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ii. Other disclosure items

We have considered two items on the basis of their importance in quarterly results. The first item is extraordinary items for which clause 41 provides that all material non-recurring, abnormal income/gain and expenditure/loss and effect of all changes in accounting practices affecting the profit materially must be disclosed separately.

Our survey results reveal that 17 companies out of 50 in the sample have disclosed extraordinary items (e.g. employees separation compensation, provision for contingencies written back, provision for diminution in value of investment, etc) under a separate heading in the quarterly results. The rest 33 companies are supposed to have no extraordinary items. Out of 17 companies, 10 have disclosed extraordinary items in details, and seven have disclosed the net amount of such extraordinary items without disclosing the nature and detailed break-up. The extraordinary items should be disclosed in details.

The second item is consolidated financial results. According to Clause 41 of listing agreement, a company will have the option to publish consolidated quarterly financial results in addition to unaudited quarterly financial results of the parent company. Our survey reveals that three companies out of 50 have published consolidated quarterly financial results along with unaudited quarterly financials. The 47 other companies did not publish such results.

iii. Audit Qualification

Clause 41 provides that when the auditor has qualified the accounts of the previous accounting year and if such qualifications may materially impact the current quarterly result, the company should disclose the same with explanatory statement. Our survey reveals that five companies out of 50 have addressed audit qualification in quarterly results. The issues on which the last year's results of five companies were qualified by the auditors relate to non provision for diminution in long-term strategic investment, non-provision for shortfall in recoveries against debt and advances, accounting of claims for escalation of input costs and other claims pending final issuance of Govt. notification. The managements of the respective companies have, however, opined that diminution in value is temporary in nature, debts and advances are good for recovery and recognition of claims are just. It can be said that disclosure of audit qualification and explanation in unaudited financial results has acquired no less value and shareholders are required to pay attention to it.

iv. Audit/Limited review of quarterly results

During the period for which interim results of sample companies are considered, Clause 41 required limited review of half-yearly results by the statutory auditor. Such limited review may be done within two months of the end of the half-year. As quarterly results are published within 1 month of close of the quarter, such results may or may not be reviewed at the time of publication. A company may publish audited quarterly results after a full-fledged audit. Such an audit may be necessary when the question of interim dividend arises (Basu, B. K. 1981). We found out in the survey that of 50 companies, five have published quarterly results for the 3rd quarter ended on September 30, 2002, and one company of the above five has published audited results. The rest sample companies (45) have published their half-yearly results for the 2nd quarter-ended September 30, 2002. They include one sample company having published only half-yearly results without disclosing quarterly one. It may be considered as the violation of SEBI guidelines. Out of 45 sample companies that have published half yearly results, 15 have published their results after conduct of limited review by the auditor. Thus, in majority of the cases (i.e., for 30 companies), limited review was conducted after publication of the results.

v. Timeliness of preparation

Timely release of interim results in the financial community is very important since decisions based on financial data are made daily and require current financial information. Before publication, financial results are required to be approved in Board Meeting. Release of interim financial results depends on how quickly it is placed and approved in board meeting after the end of interim period. From our survey of audited/unaudited quarterly results of 50 listed companies as on 30th September, 2002, we have classified the companies according

to the timespan in days from 30th September, 2002 to the date of board meeting. Out of 50 companies, 40 have approved financial results in board meeting held between 20 and 30 days from the end of the quarter, six companies in between10 and 20 days, two companies in between 30 and 40 days, one company in between 1 and 10 days and one other company has not disclosed the date of board meeting. Therefore only one company out of 50 of the sample is found to be most efficient in getting its financial results approved in board meeting held in between 1 and 10 days.

Clause 41 requires publication of interim financial results within 48 hours after the conclusion of the Board Meeting. Our survey reveals that out of 50 companies, 33 have been able to publish results in one day and the rest 17 in two days.

Conclusion

The real utility of interim financial reporting is reflected from the fact that it provides latest data to investors and investment analysts in the process of continuous reporting to update and adjust their projections about future health of the company. The frequency of interim reporting varies from country to country. With the liberalization of financial and capital market in the late 1980's, there has been mounting pressure on India Inc to provide good quality information on international standards in both financial and private sectors to promote the stability of the market.

Minimum (material) disclosure requirement now dictates the quality of the information that must be provided to the market participants and to the general public. The timing of disclosure is also important. The public disclosure of information is predicated on the existence of good accounting standards and adequate disclosure methodology (Greuning, Hennie, Koen, ed-2nd). In India, interim financial disclosure practice has not been developed to such extent as required by market participants. There is misuse of this vehicle to dupe the small investors by disclosing extraordinary information of performance (Business Standard, 2004).

Therefore, it goes without saying that limited review of quarterly results by the statutory auditor should be given more emphasis. Finally, it is suggested that an endeavour should be undertaken by the SEBI to make AS 25 mandatory for the listed companies in preparation of interim financial report instead of interim financial results. ■