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## THE INFORMATIVE VALUE OF INTERIM REPORTS OF LISTED COMPANIES: THEORETICAL AND APPLIED ASPECTS

**Keywords:** interim report, business communication

**Słowa kluczowe:** sprawozdania finansowe, komunikacja biznesowa

**JEL classification:** K22, D47

### Framework and objectives

Lately we have witnessed an overall evolution of corporate communication focused on the need for improvement as required by both the main international standard-setters and by the academic world. Companies need to develop a suitable information system to generate a flow of information that meets the knowledge expectations of its stakeholders.

In the case of listed companies, stakeholder agreement is emphasized given that one of the conditions for the survival of companies is their ability to attract funds in the presence of alternative investment sources.

Attracting funds is connected to the companies' ability to provide information in time, aimed at consolidating the relationship with the shareholders at the given moment and at attracting others in the future.

It is important to emphasize that timeliness is a vital ingredient of relevant information for users of business reporting. Its users need to understand any important changes affecting a company in time, before they decide to commit or continue to commit capital to a company and, in extreme circumstances, allow these users time to effect changes in a company to improve or protect the value of an investment. Companies use business reporting as one vehicle to report important changes. Thus, the frequency of that reporting determines whether such changes are communicated promptly (AICPA, 1994).

Given this, the period between two annual financial statements is too long with regard to the need of various stakeholders to obtain information on developments in business management regarding economic and financial performance.

In this spirit, interim reporting belongs to the field of periodic communications and is characterized by its essentially accounting nature.

This work focused on the examination of different types of interim reports submitted by the listed companies analysed in accordance with the provisions of IAS 34 and Appendix D of Consob Regulation.<sup>1</sup>

The choice of focusing attention on the interim report draws on discussions in the IASB on the need to further define the information that accompanies annual financial statements.<sup>2</sup> The issue develops around the various proposed alternatives, both in IAS 34 and Appendix 3D, now used to prepare interim reports. Starting from these alternatives the aim of this work is to observe the interim and quarterly reports of companies listed on the FTSE MIB, to understand the choices made. For this purpose, the work is structured as follows: sections 2 and 3 provide a brief analysis of the course of international and national legislation and some comments; section 4 describes the methodology used, and finally, we present the empirical research and some concluding remarks.

### **Interim reporting in business communications: theoretical and regulatory indications**

The first step in the regulation of interim reporting comes from the American Board, Accounting Principles Board (APB) with Opinion N.28. It represents the first attempt by the private rule-making body to develop accounting principles for interim financial reporting. The two primary objectives of APB Opinion N.28 were to develop accounting principles and disclosure requirements that are appropriate for interim statements and to detail the minimum guidelines for reporting interim information by publicly traded companies. Interim financial reporting refers to the issuing of financial information for some time period shorter than the entire year. An interim period may be, for example, a month, a quarter of a year, or half a year.

In Europe, the regulation was originally set up by the IASC<sup>3</sup> which in 1992 in conjunction with the London Stock Exchange, clarified the accounting principles to be adopted by

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<sup>1</sup> The regulation was adopted by Consob Resolution 11971, 14 May 1999 and subsequently amended by Consob Resolution n.15960, 30 May 2007 Article 82 (quarterly report). Issuers of shares, within forty-five days after the end of each quarter, make a quarterly report, prepared by the administrative body, in accordance with the principles laid down for the annual and consolidated financial statements for the current year, available to the public at their registered offices. The quarterly report is prepared in accordance with Appendix 3D or the international accounting standard on interim financial reporting.

<sup>2</sup> It should be added that, during 2011, the IASB launched its first formal public agenda consultation on its future work plan. Through the agenda consultation the IASB sought input from all interested parties on the strategic direction and the broad overall balance of the work plan. The agenda consultation will provide the Board with important input when considering possible agenda items. IAS 34 is one of the reports considered for amendment. *Agenda Consultation 2011, IFRS, 2011*, p. 24, [www.ifrs.org](http://www.ifrs.org).

<sup>3</sup> The International Accounting Standards Committee (IASC), founded in London in 1973, is now called the International Accounting Standards Board (IASB). It is the agency responsible for the issuing of international accounting standards. The IASB was founded on April 1, 2001, [www.ifrs.org](http://www.ifrs.org). Recently, Oxford

companies when preparing interim reports. Afterwards, in August 1997, following the usual standard development path of the IAS, Exposure Draft E57 Interim Financial Reporting was issued, which, in 1999, became IAS 34 Interim Financial Reports.

The objectives of IAS 34 are to set out the minimum content of Interim Financial Reports and the principles for recognition and measurement in financial statements presented for an interim period. Interim financial reporting means a financial report containing either a complete set of financial statements (as described in IAS 1 *Presentation of Financial Statements* (as revised in 2007)) or a set of condensed financial statements (as described in IAS 34) for an interim period. As seen, the *Interim period* is a financial reporting period shorter than a full financial year. The accounting principle at issue outlines the content, after having defined the objectives of the periodic information and the need for listed companies to publish an interim report within 60 days of the end of the first half of activity. It then dedicates much space to the accounting principles to be followed in the detection and evaluation of elements of financial statements. It should be noted that IAS 34 does not provide a specific list of additional information to be given as it favours a principle-based approach, according to which, information to explain significant events for the sub-period and provide a minimum amount of notes (par. 6 IAS 34) should be used (Lucchese, 2012).

In Italy, periodic reporting requirements for listed companies are set out in the Regulations for the implementation of Decree Law n.58<sup>4</sup> regarding issuers, identified as *Issuer Rules*. The Regulations lay down the obligation to draw up a quarterly report prepared by management in accordance with the principles set out for the annual and consolidated accounts of the year. At the same time, it is important to note how the regulation, unlike the six-monthly report that must necessarily be prepared in accordance with the provisions of IAS 34, foresees the possibility of “issuers” choosing to draw up quarterly reports either in accordance with IAS 34 or according to Appendix 3D of the Issuers Regulation. As we will see below, this Appendix foresees the publication of less information than that required by international standards

Such a normative regulation may appear in contrast to the axioms of the company accounts: comprehensibility, relevance, reliability, comparability and completeness, which also provide a better understanding of the accounts.

A conflict between company account axioms and quarterly provisions may arise, especially with regard to reliability.

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University Press has published *Financial Reporting and Global Capital Markets: A History of the International Accounting Standards Committee, 1973 2000*, by Kees Camfferman and Stephen A. Zeff. The book examines the history of the IASC from 1973 to 2000, including its foundation, operation, changing membership and leadership, achievements and setbacks, the development of its standards, and its restructuring leading up to the creation of the IASB in 2001, [www.ifrs.org](http://www.ifrs.org).

<sup>4</sup> Consob n.11971, 14 May 1999 and subsequently modified with Consob deliberation n. n. 1596,0 30 May 2007 Art. 82 (*Relazione trimestrale*).

In addition, for companies obliged to prepare a quarterly report, certain information requested by IAS 34 may sometimes not be assessable within the time limits established for releasing the report to the public.

It should also be highlighted that Issuers' Regulations state that modes of submission of financial statements and level of detail are left to the discretion of the issuer.

### **Some critical considerations about interim reports**

It is necessary at this point to emphasize that in drawing up interim financial statements two main issues are highlighted.

The first concerns the relationship between the accrual and unitary nature of managing. In interim reports, sub-division of administration procedures and controls is inevitable and therefore the use of estimates and guesswork is more critical.

The issue has been dealt with differently by accounting standards developed in various international contexts. For example, the U.S. principle focuses on the determination of an interim income as an estimate of the total income for the year. Instead, accounting systems based on the conservatism principle (which includes recognition of expected losses and non-recognition of unrealized gains) do not influence financial statements with subjective expectations of values.

The second issue concerns the trade-off created between completeness and timeliness. Timeliness of information can often lead to the emergence of issues of content.

Thus, haste in the preparation of interim reports should be avoided so that there is no reduction in reliability. It is important that timely information and reliability of periodic disclosure should be interpreted in the light of updated relevant information, obtained at short intervals.

Likewise, there is the need for external information to be articulated, complete and timely.

The use of qualitative and quantitative information in interim reports provides a more frequent and timely disclosure of information related to the financial situation of the companies which may influence market choices.

Moreover, measurements of partial, quarterly or half yearly results, provides management with the opportunity to better monitor trends in business and implement in a timely manner, if necessary, corrective action in the reformulating of plans and programs of management. From the analysis of interim reports, deviations in cash flows, process times, production efficiency and other economic variables can be deduced, helping to guide company activities towards management actions aimed at making choices of strategic and operational flexibility.

A firm's performance can be judged on the basis of distinct profiles: economic, financial and monetary. In the medium- to long-term, business continuity is ensured only if positive components of income cover negative components, the so-called balanced income.

Especially in companies characterized by production cycles for the entire accounting period, balanced income must be associated with financial and monetary balance. Therefore, in judging the performance of a company based on a limited time period, such as quarterly, it may be more useful to know the evolution of the financial and monetary administration; this might allow us to understand whether a company has generated or absorbed liquidity during the quarter. In this spirit, it could be affirmed that it would be more useful, with reference to short periods of time, to define the result of a company or of its specific segment, in terms of cash flow, rather than of net income or operating income.

Income is calculated as a difference between revenues and costs pertaining to the accounting period considered, and a cost is considered as pertaining to the year if it has been covered by related revenue. Therefore, costs and revenues for quarterly results – when the production cycles from which they originate are not completed – give estimates and assumptions which are notably higher than those used in annual financial reports. Therefore, consolidated cash-flow statements and changes in shareholders' equity are of considerable importance (Del Pozzo, 2011).

### **Definition of research hypotheses and methodology**

The aim of this study is to observe different types of interim reports of companies in the FTSE MIB in order to verify the application of IAS 34 and other particulars relating to interim reporting.

In particular, attention was paid to the findings arising from the choices made by the companies observed on a type of full (IAS 1) or more synthetic (IAS 34) report. Subsequently, the survey addresses the quarterly reports prepared by the same companies according to the provisions of Consob Regulation no. 11971 (Appendix 3D).

Therefore, we tried to see how companies in the FTSE MIB drew up their semi-annual report of 2010, distinguishing among:

- companies which submitted condensed information, in accordance with IAS 34,
- companies that, in addition to the latter, have included complete financial statements or, in any case, used them in their annual reports,
- companies who published complete information, in accordance with IAS 1.

Regarding quarterly reports, the behaviour of companies in the sample FTSE MIB was analyzed in reference to the choice among:

- the content of the quarterly report in accordance with Appendix 3D,
- the content of the quarterly report in accordance with Appendix 3D, but with a greater level of detail of the reports and the information provided,
- the content of the quarterly report complying with the criteria of IAS 34,
- the content of the quarterly report complying with the criteria of U.S. GAAP.

## Theory and practice of interim reports of listed companies: the Italian context

As mentioned above, the objective of IAS 34 is to lay down the minimum content of an interim financial report and to set out the principles for recognition and measurement in complete or condensed financial statements for an interim period.

Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an entity's capacity to generate earnings and cash flows and its financial condition and liquidity.<sup>5</sup>

Its application, as mentioned above, is mandatory for the preparation of the interim reports of listed companies.

With regard to condensed financial statements, the standard specifies that they must contain at least each of the headings and subtotals that were included in its most recent annual report, stating however, that nothing in this Standard (IAS 34) is intended to prohibit or discourage an entity from publishing a complete set of financial statements (as described in IAS 1) in its interim financial report, rather than condensed financial statements and selected explanatory notes. If an entity publishes a complete set of financial statements in its interim financial report, the form and content of those statements shall conform to the requirements of IAS 1 for a complete set of financial statements.

### Half-year report

Before presenting the data obtained from the analysis concerned, it should be noted that companies belonging to the banking sector, which prepare financial statements on the basis of Circular no. 262, were classified as firms that provide prospectuses which are more extensive than those required by IAS 34. The same consideration should be made with respect to insurance companies; while presenting more comprehensive financial statements<sup>6</sup> they have been regarded as enterprises that draw up more detailed reports, despite publishing concise information. The analysis of the different types of half-year reports of companies in the sample is shown in Figure 1.

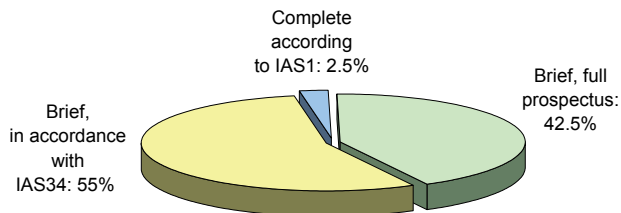


Figure 1. Breakdown of different types of half-year reports

<sup>5</sup> Website: [www.ifrs.org](http://www.ifrs.org).

<sup>6</sup> ISVAP 6 July 1999 n. 1207 "Interim Report of insurance and reinsurance" so amended by the following measures: n. 2184 of 2003 n. 2372 of 2005 and n. 2460, 10 August 2006.

It should be noted that, without the semi-annual reports of companies in the banking and insurance sectors which prepare interim financial statements using the full prospectus, 87.5% of companies present a brief interim report in accordance with IAS 34. Detailed results presented in Figure 2 show a preference for enterprises to reduce the amount of interim information.

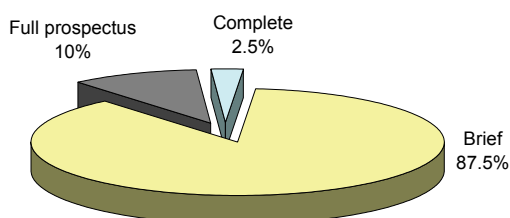


Figure 2. Breakdown of different types of half-year reports (excluding companies in the banking and insurance sectors)

### Quarterly reports

To complete the description of the periodic information, we must now turn to the quarterly reports. Companies preparing half-yearly reports must publish information relating to the quarter. As mentioned above<sup>7</sup>, companies can choose the level of detail of their disclosures. The analysis of the different types of quarterly reports of companies in the sample is shown in Figure 3.

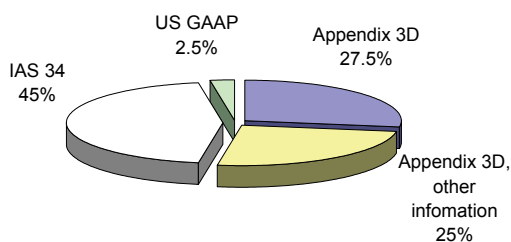


Figure 3. Breakdown of different types of quarterly reports

As can be seen, 27.5% of the FTSE MIB companies draw up their quarterly reports in accordance with the provisions of Appendix 3D, providing very brief informative reports, while 45% of the companies follow IAS 34 guidelines.

<sup>7</sup> This refers to the choice given to companies to include the presentation of a condensed report, according to international standard IAS 34, or a complete report, according to IAS 1.

Only the Luxottica Group draws up reports based on US GAAP guidelines. Other companies instead give more detailed information, although their contents are based on Appendix 3D.

## **Conclusions**

This paper explains how the information needs of stakeholders are partly satisfied by the publication of interim reports, whose content is dictated by several principles, including IAS 34-Interim reporting. In describing the contents of this principle, it was considered appropriate to analyze the various types of interim reports of the companies comprising the FTSE MIB taken as the reference sample. The research conducted has revealed some interesting data that may however be more indicative if integrated with the same type of survey referred to a wider observation period.

It would be desirable to observe the behaviour of the companies regarding interim reports for the current period, characterized by a severe economic and financial crisis. With reference to the half-year report, it has been shown that the majority of companies present condensed information as envisaged by IAS 34, rather than conform to the provisions of IAS 1.

Regarding quarterly reports, it was found that just over half of the companies draw up brief reports in accordance with Appendix 3D of the Issuers Regulation, the rest, however, comply with the provisions of IAS 34.

The trend towards less detailed presentation of information with the decrease of the reference time period (detailed in accordance with IAS 1 for the annual financial statements – brief as set forth in IAS 34 for the half-year reports – limited as per Appendix 3D for quarterly reports), responding to the needs of relevance and cost does not seem to be criticisable. A mix has been created of more detailed half-yearly reports and less stringent quarterly information.

Based on the above consideration, it is possible to draw conclusions on the arguments discussed: little relevant information, which results in higher costs compared to the benefits which may result from its publication, losing any usefulness, can certainly be omitted. Although considerable effort has been made by various national and international organizations, in reference to interim reports and despite the fact that companies involved in the publication of these interim reports have complied with the relevant regulations – even if in different ways in each case, as can be seen from the analysis of the sample – so much more can be done with a view to disclosure of higher quality information that can provide a correct view of company performance and in this way bridge the connection with the external environment by increasing the transparency of activities and reducing market uncertainty.



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### Summary

By the first half of the 1970s, an obligation for listed companies to provide financial reports that divided the full financial year into shorter periods was in force in Italy.

Given the considerable diffusion of tools of public participation in venture capital, the improvement of external information - business and financial statements which provide more frequent information on companies – is regarded as fundamental in enhancing the level of investor confidence (Breton, Taffler, 2001).

This paper aims to empirically investigate the various levels of interim reports of the financial statements of some Italian and foreign companies.

After briefly defining the theoretical scenario referring to interim disclosures and some critical aspects, a hypothesis framework to orient the investigation is presented.

The reference sample used for the empirical analysis is made up of interim reports published by 40 Italian and foreign companies listed on the FTSE MIB, with are considered representative since they reflect all sectors of activity of listed companies. Some critical considerations emerged from the analysis.

It was found that the majority of companies produce condensed information, choosing completeness rather than timeliness. In addition, most companies draw up quarterly reports following the less schematic provisions of the Issuers' Regulation. The last period over which the analysis is based is the first half of 2010 for the half-year and the first quarter of 2010 for the quarterly reports.

### WARTOŚĆ INFORMACYJNA RAPORTÓW OKRESOWYCH SPÓŁEK GIELDOWYCH: ASPEKTY TEORETYCZNE I PRAKTYCZNE

#### Streszczenie

W połowie lat 70. XX wieku we Włoszech pojawił się wymóg tworzenia przez spółki giełdowe sprawozdań finansowych, które dzielą rok podatkowy na krótsze okresy.

Biorąc pod uwagę znaczne rozpowszechnienie narzędzi publicznego udziału w Venture Capital, poprawa informacji zewnętrznych – sprawozdań biznesowych i finansowych, które częściej zapewniają informacje o spółkach – uznawana jest za kluczową dla podniesienia poziomu zaufania inwestorów (Breton, Taffler, 2001).

Niniejszy artykuł ma na celu empiryczne zbadanie różnych poziomów raportów okresowych ze sprawozdań finansowych niektórych włoskich i zagranicznych przedsiębiorstw.

Po wyznaczeniu w skrócie teoretycznego scenariusza, odnoszącego się do raportów okresowych i kilku kluczowych aspektów, określono ramowe hipotezy wyznaczające kierunek badań.

Na próbę wykorzystywaną do analizy empirycznej składają się raporty okresowe opublikowane przez 40 włoskich i zagranicznych spółek indeksu giełdowego FTSE MIB. Zostały uznane za reprezentatywne, ponieważ odzwierciedlają one wszystkie sektory działalności spółek giełdowych. Z analizy wyłoniły się pewne krytyczne uwagi.

Stwierdzono, że większość firm podaje skondensowane informacje, wybierając kompletność zamiast krótkiego czasu publikacji. Ponadto, większość firm sporządza raporty kwartalne według schematycznych przepisów rozporządzenia Consob nr 11971 z 14 maja 1999 r. Ostatni okres poddany analizie to pierwsza połowa 2010 roku dla raportów półrocznych oraz pierwszy kwartał 2010 roku dla raportów kwartalnych.