

PUBLIC STATEMENT

Improving the quality of disclosures in the financial statements

1. The European Securities and Markets Authority (“ESMA”) issues this Public Statement in order to promote the improvement of the quality of disclosures in IFRS financial statements. ESMA would like to stress the need for concise and clear disclosures focused on the relevant facts that are specific to the entity and that are necessary to understand its financial performance and position.

Background

2. In recent years, users of financial information have expressed concern about the lack of relevance and completeness of the information provided in the financial statements. They believe the financial statements do not always provide sufficiently relevant and entity-specific information. On the other hand, the increasing size of annual reports (defined as IFRS financial statements together with the management report and any other material published as part of a single document) has caused increasing concern amongst users and preparers (that is, issuers) of such reports, usually referred to as “disclosure overload”. Some users believe that key messages may be obscured or lost in the detail. However, other users do not see a problem in a large amount of disclosures in the IFRS financial statements as such. Issuers, on the other hand, question whether an appropriate balance is achieved between the usefulness of the information which they provide compared with the cost and effort in preparing that information.
3. The way in which IFRS disclosure requirements are drafted by the standard setter, applied by issuers, audited by auditors and enforced by enforcers are all indicated (though not necessarily with the same weight) as contributing to the growth in size of annual reports, mainly because there is too much emphasis on formal compliance rather than on the relevance of the information provided.
4. ESMA has already publicly expressed¹ concerns about the quality of disclosures, whether because disclosures are boilerplate² rather than entity-specific, or are unnecessary, because they refer to transactions that are not relevant to the issuer or relate to immaterial items. In addition, ESMA indicated that a query from enforcers is not

¹ Statement on European Common Enforcement Priorities for 2013 financial statements, ESMA, 11 November 2013

Statement European Common Enforcement Priorities for 2014 financial statements, ESMA, 28 October 2014

² For example, standardised language such as extensive quotation from a standard or model accounts that does not reflect the specific circumstances of the issuer

necessarily an indication that additional disclosures should be made. At national level, European enforcers in France³, Ireland⁴, the Netherlands⁵ and the United Kingdom⁶, have taken initiatives in this area, inviting issuers to improve the quality of disclosures in the financial statements. In addition, the IASB is addressing the requirements for disclosures as part of the *Disclosure Initiative* (see paragraph 7 below).

5. Nevertheless, despite all the above mentioned initiatives, the quality and quantity of disclosures in financial statements continues to cause concern and relatively few issuers have taken initiatives on this aspect so far.

Statement

6. ESMA emphasises the need to improve the quality of disclosures in financial statements. Improving disclosures is not only a matter of quantity but also of quality of information. Issuers should plan sufficiently far in advance and step outside the simple updating process of financial statements from previous years in order to improve the disclosures in their financial statements. ESMA believes the following principles/objectives should be considered regarding the disclosures made in annual reports:
 - a. **Telling the entity's own story.** Issuers should focus on entity-specific disclosures and avoid boilerplate language. IFRS is principle-based but disclosure requirements are sometimes applied as if they were rules-based. When applying IFRS, issuers should be as specific as possible to their own circumstances. The use of boilerplate text in the financial statements without tailoring to the specifics of the entity offers less or even no valuable information to users. For example, an investor should be able to identify significant accounting policies, that is, those that are important or unique to the business' operations, where there is a choice of policy under IFRS or where significant judgement has been exercised in the selection and/or the application of the policy.
 - b. **Providing relevant information in the financial statements in an easily accessible way.** Relevant information is information that is necessary to understand the issuer's financial performance and position and that could influence an investor's economic decision. Investors should be able to easily access relevant entity information in the financial statements. For example, an

³ The French Authority for the Financial Markets (AMF) published the "Guide to the relevance, consistency and readability of financial statements" in June 2015:

http://www.amf-france.org/en_US/Publications/Guides/Professionnels.html

⁴ The Irish Audit and Accounting Supervisory Authority (IAASA) published "Observations on selected financial reporting issues" in October 2013:

http://www.iaasa.ie/IAASA/flipbooks/publications/obsdoc2013/Observations_on_selected_Financial_Reporting_Issues.pdf

⁵ The Netherlands Authority for the Financial Markets (AFM) published a thematic review on "The scope and quality of disclosures – Audit and reporting quality" in October 2014:

<http://www.afm.nl/en/professionals/doelgroepen/effectenuitgevendende-ondernemingen/financiele-verslaggeving/publicaties>

⁶ The UK Financial Reporting Lab (FRC) published the report "Towards clear and concise reporting" in August 2014:

<https://www.frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/FRC-Lab-Towards-Clear-Concise-Reporting.pdf>

investor should be able to identify an issuer's main revenue streams and their relative contribution to total revenues.

- c. **Thinking about materiality.** IFRS refer to the principle of materiality, which, when applied, should result in adapting the level of detail of the information provided in the financial statements based on the relative importance of the transactions, other events and specific conditions concerned. Effective use of the materiality concept should enhance the clarity and conciseness of financial statements. While all relevant information should be contained in the IFRS financial statements, issuers should review elements which are no longer relevant, remove elements which are no longer required and consider deleting immaterial information from the financial statements. For example, an accounting policy is not required to be disclosed if it does not apply to any item in the financial statements.
 - d. **Promoting readability of the financial statements.** Financial statements should be written in as clear and concise a way as possible while still including all material information. The most relevant information should not be obscured by a large amount of less relevant information. Financial statements should be user friendly and issuers should help readers understand the financial information. Issuers should consider reorganising the financial statements, using cross-referencing when possible or modifying the layout to improve conciseness and clarity.
 - e. **Providing consistent information within annual reports.** IFRS financial statements are usually published together with other documents, for example, the management report. Users expect consistency between information included in the financial statements and information included in the accompanying documents. Issuers and auditors should ensure such consistency.
7. ESMA also supports improving disclosures through the early application, where permitted, of elements from the IASB Disclosure Initiative⁷, described as a broad initiative to explore how disclosures in IFRS financial statements can be improved. The first short-term results of the Disclosure Initiative were seen in the publication of a number of amendments to IAS 1 *Presentation of Financial Statements* in December 2014, which ESMA encourages issuers to consider carefully, especially paragraph 30A, regarding the obscuring of material information, paragraph 31, which states that a disclosure is not required if the information resulting from that disclosure is not material, and paragraph 113, which states that, in determining how to present the notes to the financial statements, an entity should consider the effect on the understandability and

⁷ IASB disclosure initiative is made up of a number of implementation and research projects as described in: <http://www.ifrs.org/Current-Projects/IASB-Projects/Disclosure-Initiative/Pages/Disclosure-Initiative.aspx>

comparability of its financial statements. The IASB is now moving on to long-term projects in this area. ESMA is closely following the IASB Disclosure Initiative, supports its overall aim and looks forward to the timely conclusion of this important project.

8. ESMA acknowledges that improving disclosures is a continuous process and urges all parties involved to address the issue.
 - ESMA encourages issuers to consider how to improve their disclosures by focusing on those which are relevant and material, making them as specific as possible to their circumstances and increasing their readability and consistency.
 - ESMA also encourages auditors⁸ to contribute to this process, by encouraging issuers to focus on materiality and on entity-specific and relevant information in the financial statements.
 - European enforcers will continue to encourage best practice amongst issuers in making disclosures more relevant and effective. Enforcers will also continue monitoring and discussing together the progress of the various initiatives aimed at improving disclosures and will reflect on their enforcement practices in the light of this statement.

⁸ IAASB has revised several International Standards on Auditing (ISAs) in the work stream "Addressing disclosures in the Audit of Financial Statements": <http://www.ifac.org/publications-resources/addressing-disclosures-audit-financial-statements>