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cutting through complexity

Improving the quality of disclosures

Recommendations for financial institutions

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IN THE HEADLINES

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> “Effective disclosure requires a focus on the issues that really matter, within a structure that users can navigate and compare.”

– Chris Spall,
KPMG’s global IFRS financial instruments leader

Working towards transparency and comparability

Following the financial crises, transparency and comparability of the financial statements of financial institutions have gained increased importance for users. To help address this demand, the European Securities and Markets Authority (ESMA) recently published a review of the comparability and quality of disclosures in the 2012 financial statements of 39 major European financial institutions.

ESMA expects financial institutions and their auditors to consider the findings of this review when preparing and auditing 2013 IFRS financial statements.

As with ESMA’s recently announced enforcement priorities for 2013, we expect that regulatory bodies within and outside of Europe will take notice of this report and pay particular attention to these areas of focus for financial institutions.

Room for improvement

The review, published on 18 November 2013, identified a wide variability in the quality of the information provided – particularly within financial instruments disclosures. A number of cases were cited in which the information provided was insufficient or insufficiently structured to allow comparability with other financial institutions.

On the basis of its review, ESMA proposes several recommendations that it believes will enhance the transparency of financial information in this sector.

Areas of focus

ESMA believes that the quality and comparability of IFRS financial statements could be enhanced in the following areas:

- structure and content of the income statement;
- liquidity and funding risk, including asset encumbrance;
- hedging and the use of derivatives;
- credit risk, with a focus on credit quality, forbearance practices, non-performing loans and concentrations of risk; and
- criteria used to assess the impairment of equity securities that are classified as available-for-sale.

The table on the opposite page gives more detail on the recommended information to include for each of these areas.

Implications for financial institutions and beyond

ESMA, together with national regulators, is expected to focus on monitoring the level of impairment of financial assets and improving the level of transparency in the areas of forbearance, liquidity risk, asset encumbrance and fair value measurement.

Where ESMA believes additional guidance in IFRS is needed to improve the quality and transparency of financial statements, it will provide suggestions to the IASB.

Time to think about your disclosures …

Consider the findings and recommendations of ESMA’s Review of Accounting Practices when preparing your IFRS financial statements and specific disclosures to help improve transparency and overall compliance with IFRS.

For more help with these areas, speak to your usual KPMG contact or go to our publications Guide to annual financial statements: Disclosure checklist and Insights into IFRS.

Recommended inclusions for each area of focus

Area of focus	Recommended inclusions
Structure and content of the income statement	• Concise yet comprehensive accounting policy disclosures that link income statement and balance sheet. • Identification of all significant components included in individual line items – e.g. interest income/expense. • Single note to disclose breakdown of total net gains or net losses on financial instruments. • Consistent presentation over time and explanation of the impact of any presentation changes.
Liquidity and funding risk, including asset encumbrance	• Clear, interlinked view of maturity analysis of financial instruments (including financial assets), liquidity position, funding sources and the way in which the entity manages its liquidity risk. • Integrated quantitative and narrative disclosures, including definitions of key terms and assumptions. • Concentrations of liquidity and funding sources, including analysis by significant currencies. • Quantitative information about encumbered and unencumbered assets.
Hedging and the use of derivatives	• Qualitative information on the use of derivatives for different purposes and link to accounting treatment. • Effectiveness of hedging activities. • Valuation methodologies and inputs, including impact of credit risk adjustments. • Extent of macro hedging and use of the EU 'carve-out'.
Credit risk, with a focus on credit quality, forbearance practices, non-performing loans and concentrations of risk	• Link between information on credit exposures and balance sheet. • Reassessment of significant concentrations of risk – e.g. significant 'at risk' countries. • Information on how concentrations are managed and risks mitigated – e.g. use of credit derivatives, allocation of collateral. • Description of internal rating system. • Quantitative information on forbearance. • Accounting policy for no longer classifying loans as forborne.
Criteria used to assess the impairment of equity securities that are classified as available-for-sale	• Specific and reasonable criteria used to determine when a decline in the fair value of an available-for-sale equity security is significant *or* prolonged (as opposed to significant *and/or* prolonged).

About ESMA

ESMA is an independent EU authority that contributes to safeguarding the stability of the EU's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection. More information about ESMA can be found at www.esma.europa.eu.

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