AN ANALYSIS OF THE DISCLOSURE OF FINANCIAL INSTRUMENTS BY SELECTED COMPANIES ON THE JSE LIMITED

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Abstract

The financial crisis of the 21st century arising from the credit and sub-prime crisis has resulted in the accounting for financial instruments being placed under intense scrutiny. In reaction to this, the International Accounting Standards Board commenced a comprehensive review of financial instruments and the related accounting standards. This article analyses the disclosure of financial instruments by performing a literature review of the principles underlying financial instruments disclosure, followed by an empirical study of the current practices of the disclosure of financial instruments by selected companies on the JSE Limited. This article indicates that in certain aspects of the disclosure practices related to financial instruments, the “through the eyes of management” approach is not followed in the companies selected – a principle established in International Financial Reporting Standard 7 (IFRS 7).

Keywords: Financial instruments disclosure, financial crisis, IFRS 7, fair presentation, financial reporting

1. INTRODUCTION

The financial crisis of the 21st century arising from the credit and sub-prime crisis has resulted in the accounting for financial instruments being placed under intense scrutiny. The calls for action from the business community and society at large to prevent a repeat of the financial crisis in 2008 have also touched on accounting standard setting and the way in which accounting information (or lack thereof) contributed to the crisis (Barth & Landsman, 2010:400). In a study conducted by the Securities and Exchange Commission (SEC) in 2008 following the crisis, the presentation and disclosure requirements of fair value measures, among other things, are cited as areas warranting improvement (SEC, 2008:5). In response to the concerns raised about the accounting for financial instruments, the International Accounting Standards Board (IASB) commenced a comprehensive review of financial instruments and the related accounting standards.

International Financial Reporting Standard (IFRS) 7 Financial Instruments: Disclosures sets out disclosure requirements and principles to facilitate the disclosure of financial instrument transactions and the risks associated with these.

IFRS 7 advocates that many of the requirements in IFRS 7 are based on information provided internally to the entity's key management personnel (IASB, 2009a:para.BC10 & para.BC47). This is commonly also referred to as the “through the eyes of management” approach in more recent accounting standard setting. This article investigates the extent to which the “through the eyes of management” approach is applied by selected companies from the JSE Limited (JSE) Top 40 in their financial instruments disclosure.

2. OBJECTIVES, SCOPE AND LIMITATIONS

The objective of the article is twofold: to provide an overview of the reporting of financial instruments; and secondly to evaluate the extent to which the “through the eyes of management” approach is applied in the disclosure practices related to financial instruments in the selected companies from the JSE Top 40. This is done by way of a literature review of the current financial instrument reporting principles and practices, and is supported by empirical evidence obtained from analysing the financial instruments reporting of the selected companies.

This study has two specific limitations. Firstly, the assessment is limited to the selected listed companies in South Africa and the findings might not necessarily be representative of the financial instruments reporting practices of other listed companies and other entities. Secondly, content analysis techniques are used in the empirical study, and these techniques have specific limitations. These include the risk of gaining an incomplete picture of the company's business (as noted by Marx & van Dyk, 2011:105; and Unerman, 2000:667) and difficulties in quantifying the quality of disclosures (as noted by Beattie, McInnes & Fearnley, 2004:205-206), but content analysis is also a widely recognised and accepted research instrument in analysing reporting practices (April, Bosma & Deglon, 2003; Barac & Moloi, 2010; Guthrie, Petty, Yongvanich & Ricceri, 2004; Lajili & Zeghal, 2005; and Linsley & Shrives, 2006).

3. THEORETICAL BACKGROUND

3.1 Objective and qualitative characteristics of financial reporting

The Framework for the Preparation and Presentation of Financial Statements (Framework) sets out the objective of financial statements as to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions (IASB, 2009a:para.12).

In 2008, the IASB commenced a project to update the Framework. This project is being conducted in phases, and when each chapter is finalised the relevant paragraphs in the Framework are replaced.

When the project is completed, the IASB will have a complete, comprehensive and single document called the Conceptual Framework for Financial Reporting (Conceptual Framework). The revised objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. These decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit (IASB, 2011: para.OB2).

The Conceptual Framework sets out qualitative characteristics of useful financial information. These are grouped according to fundamental qualitative characteristics and enhancing qualitative characteristics. It is intended that information that possesses the qualitative characteristics will be useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity (IASB, 2011:para.QC1). According to the fundamental qualitative characteristics, this would be information that is relevant and faithfully represented. The usefulness of the information would be enhanced if it is comparable, verifiable, timely and understandable (IASB, 2011:para.QC5-QC19). In this regard, the adjudicators' report to the Ernst & Young Survey: Excellence in Corporate Reporting (Ernst & Young, 2010:13) made several concerning disclosure observations:

> *"The overwhelming impression of each of the three adjudicators in reviewing the financial reports is that accessibility of key information is becoming increasing difficult; More and more disclosures are required in terms of IFRS and companies are including an increasing amount of non-statutory information; In some cases, it could be argued that the disclosure requirements of the IFRS have become excessive; and our overriding message to preparers is that more is not necessarily better – emphasis needs to be placed on identifying what is really relevant and highlighting that information."*

The Ernst & Young Survey: Excellence in Corporate Reporting 2011 reports an improvement in the accessibility of information, with annual reports being more focused, with more attention and thought being given to linking the different components of the report (Ernst & Young, 2011). A possible reason for the improvement, and supported by the 2011 survey, is the move to integrated reporting, which is consistent with the connectivity of information, being one of the five guiding principles underpinning the preparation of an integrated report (IIRC, 2011).

3.2 Financial instruments disclosure and the "through the eyes of management" approach

The "through the eyes of management" approach finds its origins in the debates about narrative information in financial statements.

These debates indicate that there is consensus that the business reporting model needs to expand beyond the traditional financial reporting model, which emphasises backward-looking, quantified, financial information (examples AICPA, 1994; Beattie, McInnes & Fearnley, 2004:206; Elliot, 1992; FASB, 2001; ICAEW, 2003; ICAS, 1999; Lev, 2001; Lev & Zarowin, 1999; Wallman, 1995, 1996, 1997). The general thrust of these articles and reports is that there is a need for more information that is forward-looking and non-financial in nature. It is recognised that much of this new information will be “soft”, i.e., either unquantified or unquantifiable (Beattie, McInnes & Fearnley, 2004:206).

While many of these debates were happening beyond the borders of South Africa, forward-looking information debates were also taking place in South Africa, and this is supported by Stainbank and Peebles (2006:72), who report two South African studies (Howell, 1987; and Saenger, 1991) that examined the usefulness of forecast information or the need for future-oriented information. The findings found support for the use of forecast information by user groups (stockbrokers and unit trust management companies). The studies also report that similarities between the results of the South African studies and those of the studies done abroad exist, but there are differences between the perceptions held by the regulators and the providers of financial information, on the one hand, and by the users of the information, on the other, with regard to the perceived relative importance of various sources of information.

Over the years, the “through the eyes of management” approach has gained support, and this is also evident in external research undertaken by PricewaterhouseCoopers in 2005 across 14 countries and 16 industries, involving more than 3,100 participants (IASB, 2005a:22). The findings of this research are published in their book Trends: 2005 Good Practices in Corporate Reporting (PricewaterhouseCoopers, 2004). The research suggests that users' needs are consistent with this principle and, with few exceptions, the information important to management in managing the business is the same information that is important to investors in assessing performance and future prospects. This approach (“through the eyes of management”) was also extended to IFRS 7, in that disclosure is based on the information provided internally to key management personnel of the entity – for example, the entity's board of directors or chief executive officer (IASB, 2009a:para.34(a)). It requires financial information to be supported by non-financial information in an effort to make the financial information meaningful and useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. In paragraph BC47 of IFRS 7, the IASB further motivates the use of the “through the eyes of management” approach, because the approach:

"increased the number of reported segments and provided more information; enabled users to see an entity through the eyes of management; enabled an entity to provide timely segment information for external interim reporting with relatively low incremental cost; enhanced consistency with the management discussion and analysis or other annual report disclosures; and provided various measures of segment performance" (IASB, 2009a:para.IFRS7.BC6).

The Conceptual Framework's emphasis on financial reporting over financial statements is confirmation of the importance and support for the "through the eyes of management" approach. The notion of the Conceptual Framework being broader, encompassing not only the financial statements but more qualitative disclosures, confirms the IASB's intention and belief that further qualitative disclosures assist in achieving the objective of financial reporting. Moreover, International Accounting Standard (IAS) 1 Presentation of Financial Statements (issued in September 2007) also brings certain commentary by management within the ambit of financial statements (Coetsee & Pietersen, 2008:19). IAS 1 specifically states that significant judgements made by management in applying accounting policies (IASB, 2009a:para.122) and key assumptions concerning the future and other key sources of estimation uncertainty that could cause material adjustments to the carrying amount of assets and liabilities (IASB, 2009a:para.125) should be disclosed.

3.3 Key principles of IFRS7

IFRS 7 was first issued in 2005, with mandatory application for annual periods beginning on or after 1 January 2007. On 13 October 2008, the IASB published an amendment to IFRS 7 for disclosures relating to reclassifications of financial assets (IAS Plus, 2011). This amendment was in response to calls from constituents, particularly within the European Union, to create a "level playing field" with US GAAP regarding the ability to reclassify financial assets (Deloitte, 2008:1). The effective date of the reclassifications amendment was 1 July 2008, thereby affecting companies with year-ends of 30 June 2009 and later.

On 5 March 2009 the IASB published an amendment to IFRS 7, which enhanced disclosures about fair value and liquidity risk (IAS Plus, 2011). The amendment was part of the IASB's response to the credit crisis and was in line with the G20 conclusions aimed at improved transparency and enhanced accounting guidance. This amendment introduced a three-level hierarchy for fair value measurement disclosures and required entities to provide additional disclosures about the relative reliability of their fair value measurements. In addition, the amendment clarified and enhanced the existing requirements for the disclosure of liquidity risk (IASB, 2009b:1). The effective date for these amendments was 1 January 2009, thereby affecting companies with year-ends of 31 December 2009 and later.

IFRS 7 states that its objective is to require entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments for the entity's financial position and performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks (IASB, 2009a:para.1). Therefore IFRS 7 has two key principles. The first requires that an entity disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance (IASB, 2009a:para.7). The IASB decided to specify disclosures for this principle, and it is also its view that entities would not be able to satisfy this disclosure principle unless they disclose the information required (IASB, 2009a:para.BC13). Therefore, the “through the eyes of management” approach has a limited application here, and IFRS 7 is prescriptive as to what should be disclosed in this regard.

The second key principle requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period (IASB, 2009a:para.31). The basis of conclusions to IFRS 7 also states that while developing IFRS 7 the IASB was informed that users of financial statements value information about the risks arising from financial instruments, such as credit risk, liquidity risk and market risk, to which entities are exposed, and the techniques used to identify, measure, monitor and control those risks (IASB, 2009a:para.BC40). In order to satisfy the second key principle, IFRS 7 requires qualitative and quantitative disclosures. Qualitative disclosures require that for each type of risk an entity discloses the exposures to risk and how they arise, its objectives, policies and processes for managing the risk and the methods used to measure the risk (IASB, 2009a:para.33). Quantitative disclosures require an entity to disclose summary quantitative data about its exposure to risk, and for this to be based on the information provided internally to key management personnel (IASB, 2009a:para.34). The basis of conclusions to IFRS7 explains this approach: the requirements combine qualitative disclosures of the entity's exposure to risks arising from financial instruments, and the way management views and manages these risks, with quantitative disclosures about material risks arising from financial instruments (IASB, 2009a:para.BC41). In order to overcome incomparability between entities, IFRS 7 also specifies disclosures about risk exposures applicable to all entities (IASB, 2009a:para.BC42). Providing prescribed minimum disclosures results in a common basis for financial statement users when comparing risk exposures across different entities.

3.4 Reviews conducted on financial instruments disclosure

An internet search was done for reviews performed on financial instruments disclosure, and professional reviews were found to have been performed globally (for example BDO Stoy Hayward, 2008; Deloitte, 2010, 2011; Ernst & Young, 2008, 2010, 2011; JSE, 2012; SAICA, 2011). Table 1 reports on the findings from these reviews.

Table 1: Generic findings
The quality and format of the information disclosed varies significantly among companies.
Qualitative disclosures on liquidity risk have not significantly improved over the previous year, and the level of detail provided is highly variable.
It is not the technical interpretation of the standard or systematic information gathering issues that have caused entities the most difficulty when applying IFRS 7 for the first time. Instead, the lack of prescriptive requirements in IFRS 7 seems to have resulted in a degree of confusion over the level of disclosure that might be acceptable and, perhaps, reluctance by entities applying the standard to disclose more detailed information than they feel might be given by their peers.
There is a tendency for entities to base their disclosures only on the “minimum” disclosures prescribed in the standard and not to include information of a format or type that is clearly based on management information. Qualitative information on risk management tends to be at a higher (less detailed) level than is implied by the standard, and the detail included in accounting policies is generally low.
One of the negative impacts in relation to IFRS 7 disclosure is that in some instances important financial risks that were previously highlighted in the operational review are now tucked away in one of the last notes of the financial statements.
There has been criticism about the disclosure of accounting policies that are not tailored to the particular circumstances of an entity or of entities, including accounting policies, even when there were no material transactions falling within their scope in the current or previous year. Despite this criticism, several entities included generic and sometimes extensive policies on subjects such as designating financial liabilities at fair value through profit or loss, classification of financial assets as held to maturity, or hedge accounting, when there was little or no evidence of such treatments being adopted elsewhere in the financial statements.

In South Africa, the Financial Reporting Investigation Panel (FRIP), an advisory panel of 16 accounting experts (previously known as the GAAP Monitoring Panel) published a document titled "Omissions and Errors: September 2002 – January 2011", which summarised the FRIP's findings relating to non-compliance from September 2002 to January 2011 (SAICA, 2011). In the cases investigated, the document reports poor disclosure of financial instruments, the lack of disclosures of risk management policies and information about the extent and nature of financial instruments and the lack of disclosure of accounting policies adopted for financial instruments (FRIP, 2011). In academic research conducted by Rossouw (2010) on the accounting policies of South African listed companies, some evidence was found of a lack of proper disclosure of specific accounting policy choices, although Rossouw (2010) notes the limitations of the research. More recently, the adjudicators of the Ernst & Young Excellence in Corporate Reporting 2010 and 2011 surveys have reported improvements in financial reporting trends, with the following specific IFRS 7 trends identified:

> *"more emphasis had been placed by the top 100 companies surveyed on providing disclosures of steps taken to mitigate risks; more risk disclosures were moved into the statutory section of the corporate report; the IFRS 7 disclosure of bad debts/impairment improved; and improved disclosure on determination of fair values" (Watson & Graham, 2010:slide.10-11).*

The literature review reported on above informed the development of the checklist used in the content analysis and the interpretation of the findings and deductions. The findings of the analysis are discussed in the research findings and interpretation section.

4. METHODOLOGY

The disclosure practices related to financial instruments in the selected companies on the JSE were empirically tested through a content analysis of their annual reports. This content analysis comprised a disclosure index study and a thematic content analysis (further detail provided below).

4.1 Population

The JSE listing requirements require compliance with IFRS (JSE, 2010). Therefore all companies listed on the JSE must adhere to IFRS. The population used in the empirical study was 20 companies from the top 40 companies represented as constituents in the FTSE/JSE Top 40 Index (JSE, 2011). The FTSE/JSE Top 40 Index consists of the largest 40 companies ranked by full market volume, before the application of any investability weightings (free float), on the JSE All Share Index (Moneyweb, 2011). Some of the companies are also surveyed by Ernst & Young in its annual assessments of Excellence in Corporate Reporting (Ernst & Young, 2010, 2011).

The population was selected on the basis of four companies per sector, and where the representation of companies available was less than four, the minimum available was selected. Due to the qualitative nature of this research, the volume of financial instruments disclosure provided and the amount of in-depth analysis required for each qualitative assessment, the population was kept small.

4.2 Content analysis of annual reports

The most recently available financial instruments reporting of the companies as at July 2011 as contained in the annual reports was inspected. The content analysis comprised a disclosure index study to test the existence of specified disclosures and a thematic content analysis to test the quality of disclosures. A yes/no/not applicable scale was used in the disclosure index studies for the existence tests. A three-pronged hierarchical scale was used in the thematic content analysis for the quality tests, comprising perfunctory, standard and excellent sections (explained below):

Guideline	EXCELLENT	STANDARD	PERFUNCTORY
Accounting policies	With respect to accounting policies, if the policies are linked to each line item in the financial statements and/or explanations provided in respect of critical judgments and assumptions, the item is marked as **Excellent** in the checklist.	With respect to accounting policies, if policies are relevant but text is quoted directly from accounting standards, the item is marked as **Standard** in the checklist.	With respect to accounting policies, if irrelevant accounting policies are provided, the item is marked as **Perfunctory** in the checklist.
All other disclosure	If the required information is disclosed in a paragraph, a few paragraphs or a full page and this information contains all the standard information with enhanced voluntary disclosure, the item is marked as **Excellent** in the checklist.	If the required information is disclosed in a paragraph, a few paragraphs or a full page and this information contains all the required bare minimum information as well as the voluntary disclosures for that category, the item is marked as **Standard** in the checklist.	If the bare minimum required information is disclosed, the item is marked as **Perfunctory** in the checklist.

Source: Own analysis

While this scale may have limitations, it has been used for similar analyses of narrative information and provides a means of creating discussions about quality (as noted in Beattie, McInnes & Fearnley, 2006:229).

4.3 Research control

The analysis was performed according to a checklist developed from the literature review. The starting point was the Deloitte IFRS Presentation and Disclosure Checklist for 2009 (Deloitte, 2009:33-48). A more recent checklist was not appropriate, as these more recent checklists incorporate amendments to IFRS 7 with effective dates beyond the reporting date of the population. The Deloitte checklist was informed and modified to focus on the areas identified in the literature review that are relevant to the "through the eyes of management" approach. This checklist was tested by senior accounting academics of universities and discussed with various personnel at the JSE who are involved in securities regulation.

5. RESEARCH FINDINGS AND INTERPRETATION

5.1 Introduction

The research findings and interpretation are presented in two broad areas: accounting policies (section 5.2) and nature and extent of risks arising from financial instruments (section 5.3), these being two areas that were informed by the literature review, and that relate to the "through the eyes of management" approach. The disclosures of the nature and extent of risks arising from financial instruments are evaluated for qualitative disclosures (section 5.3.1), quantitative disclosures (section 5.3.2) and prescribed minimum quantitative disclosures (section 5.3.3). Each section includes, firstly, an analysis of the compliance with the disclosure requirement, and, secondly, an analysis of the quality of the disclosure requirement, where provided.

5.2 Accounting policies

Objective of the analysis

An entity discloses, in the summary of significant accounting policies, the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements (IASB, 2009a:para.21). IFRS 7 Appendix B5 (an appendix integral to the IFRS) provides guidance as to what relevant disclosure may include. Therefore such disclosure is not compulsory. The objective of this analysis was, firstly, to evaluate compliance with the accounting policies on financial instruments (Table 2) and, secondly, to evaluate the quality of the accounting policies (Table 3) – therefore to deduce the extent of application of the "through the eyes of management" approach with respect to accounting policies.

Findings and deductions

Table 2: Compliance with accounting policies

			Yes	No	N/A*
	Disclosure for:	**Number**	**Number**	**Number**	**Number**
(a)	Designation as fair value through profit or loss	20	10	6	4
(b)	Designated as available-for-sale	20	7	9	4
(c)	Trade date versus settlement date accounting	20	10	5	5
(d)	Allowances accounts	20	7	11	2
(e)	Determination of net gains	20	7	12	1
(f)	Objective evidence of impairment	20	9	11	0
	Total	**120**	**50**	**54**	**16**

Source: Annual report disclosure (own analysis)
**** The "not applicable category" was selected when the requirement is not relevant to the company, as it does not have that form of transaction.***

The findings in Table 2 indicate that fewer companies in the population have applied IFRS 7 Appendix B5. This suggests that the "through the eyes of management approach" is not applied by the majority of the companies in the population to accounting policies.

Table 3: Quality of accounting policies

	Perfunctory	Standard	Excellent
Number	**Number**	**Number**	**Number**
20	10	6	4

Source: Annual report disclosure (own analysis)

The findings in Table 3 raise concerns about the quality of the accounting policy disclosures of the group of companies that provide perfunctory accounting policy note disclosure. Companies with perfunctory ratings in Table 3 were characterised by irrelevant accounting policies provided – the company provided the accounting policy, but no underlying transaction existed in the accounting records for that policy. Alternatively, the company provided separate accounting policies for financial instruments, on the one hand, and for investments, loans and advances and borrowings, on the other. "Financial instruments" is a comprehensive title that encompasses investments, loans and advances and borrowings. In other cases, the bare minimum of information was provided – in many cases text quoted directly from paragraphs in accounting standards.

This resulted in key information not being provided. There were also incorrect references to equity, when such references should be to other comprehensive income. Companies with standard ratings in Table 3 quoted text directly from paragraphs in accounting standards. For example, many companies made the theoretical statement that impairments are recognised when there is an indicator of objective evidence of impairment, but few companies explained their (own) criteria for determining objective evidence of impairment. Companies with excellent ratings in Table 3 had accounting policies that are linked to each line item in the financial statements – in many cases the title of the line item on the face of the financial statements corresponded directly with the title of the accounting policy. These companies made a considerable effort to provide useful information in their accounting policies. For example, the detailed criteria used to determine objective evidence of impairment were explained in the financial information.

5.3 Nature and extent of risks arising from financial instruments

An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period (IASB, 2009a:para.31). This information must be disclosed both qualitatively and quantitatively (IASB, 2009a:para.32A), and IFRS 7 further prescribes minimum quantitative disclosures to enhance comparability. This section accordingly presents the findings and deductions for qualitative disclosures (section 5.3.1), quantitative disclosures (section 5.3.2) and prescribed minimum quantitative disclosures (section 5.3.3). Each sub-section includes, firstly, an analysis of the compliance with the disclosure requirements and, secondly, an analysis of the quality of the disclosure requirements, where provided.

5.3.1 Qualitative disclosures

Objective of the analysis
For each type of risk arising from financial instruments, an entity shall disclose the exposures to risk and how they arise, its objectives, policies and processes for managing the risk and the methods used to measure the risk (IASB, 2009a: para.33). The objective of this analysis was, firstly, to evaluate compliance with this disclosure requirement (Tables 4 and 5) and, secondly, to evaluate the quality of the disclosure provided for this requirement (Table 6) – therefore to deduce the extent of application of the “through the eyes of management” approach with respect to this disclosure requirement.

Findings and deductions

Table 4: Compliance with qualitative disclosures requirement

CREDIT RISK		Yes	No	N/A
Disclosure for:	**Number**	**Number**	**Number**	**Number**
Risk exposures	20	19	1	0
Risk management and measurement	20	19	1	0
Credit risk total	**40**	**38**	**2**	**0**

LIQUIDITY RISK		Yes	No	N/A
Disclosure for:	**Number**	**Number**	**Number**	**Number**
Risk exposures	20	17	3	0
Risk management and measurement	20	15	5	0
Liquidity risk total	**40**	**32**	**8**	**0**

MARKET RISK		Yes	No	N/A
Disclosure for:	**Number**	**Number**	**Number**	**Number**
Risk exposures	20	20	0	0
Risk management and measurement	20	17	3	0
Market risk total	**40**	**37**	**3**	**0**

Source: Annual report disclosure (own analysis)

Table 5: Findings presented in summary format

		Yes	No	N/A
	Number	**Number**	**Number**	**Number**
Credit risk total	40	38	2	0
Liquidity risk total	40	32	8	0
Market risk total	40	37	3	0
Total	**120**	**107**	**13**	**0**

Source: Annual report disclosure (own analysis)

The findings in Tables 4 and 5 indicate that for all three risk areas compliance levels within the population are high. The relatively higher levels of non-compliance in the liquidity risk area are indicated by relatively more “no” responses to the question pertaining to the disclosure of the company's objectives, policies and processes for managing liquidity risk and the measures used to measure liquidity risk. A possible reason for the finding is the lack of information available from internal reporting systems to provide the required disclosure (also noted in BDO Stoy Hayward, 2008:6).

Table 6: Quality of qualitative disclosures provided

		Perfunctory	Standard	Excellent	N/A
	Number	Number	Number	Number	Number
Credit risk	20	2	9	9	0
Liquidity risk	20	2	9	6	3
Market risk	20	2	7	10	1
Total	**60**	**6**	**25**	**25**	**4**

Source: Annual report disclosure (own analysis)

The findings in Table 6 indicate that companies that have complied with the disclosure requirement, have a strong tendency to provide more information than the bare minimum. Further, these companies were found to steer away from generic wordings in their qualitative disclosures, and instead adequately and comprehensively explain their risk exposures and their risk management strategies. This steering away from generics is seen positively, as statements of general risk management policy and a lack of coherence in the risk narratives imply that a risk information gap exists and consequently stakeholders would be unable to adequately assess the risk profile of a company (Linsley & Shrives, 2006:387). The companies achieving excellent ratings generally cross-referenced their disclosure to comprehensive risk management reports elsewhere in the annual report, and some made use of systematic diagrams to explain the information provided. The banking companies included in the population were the leaders in this analysis.

5.3.2 Quantitative disclosures

Objective of the analysis

For each type of risk arising from financial instruments, an entity shall disclose summary quantitative data about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel of the entity (IASB, 2009a:para.34(a)). The objective of this analysis was, firstly, to evaluate compliance with this disclosure requirement (Table 7) and, secondly, to evaluate the quality of the disclosure provided for this requirement (Table 8) – therefore to deduce the extent of application of the “through the eyes of management” approach with respect to this disclosure requirement.

It is important to note here that the focus of this analysis is on the existence of "information provided internally to key management" and the quality thereof. Indicators used to analyse the existence of information that is based on information provided to key management included whether generic time buckets are used for credit risk and liquidity measures (on the assumption that it is unlikely that management would monitor their debtors age analysis in buckets of 0 – 180 days when their credit terms are 45 days), the existence of unique and entity-specific analysis of risk (for example for currency risks – splits between local and export transactions), or an explicit statement that the information is based on information provided to key management personnel.

Findings and deductions

Table 7: Compliance with quantitative disclosures requirement

		Yes	No	N/A
Disclosure for:	**Number**	**Number**	**Number**	**Number**
Credit risk	20	15	5	0
Liquidity risk	20	10	10	0
Market risk	20	14	6	0
Total	**60**	**39**	**21**	**0**

Source: Annual report disclosure (own analysis)

The findings in Table 7 indicate that for all three risk areas the level of non-compliance within the population is high. For credit risk quantitative disclosures, 25% of the population did not provide quantitative disclosures based on information provided to key management personnel. For liquidity risk and market risk, the percentage of non-compliance was 50% and 30% respectively, with an overall non-compliance percentage of 35%. Once again, a possible reason for the finding is the lack of information available from internal reporting systems to provide the required disclosure (also noted in BDO Stoy Hayward, 2008:6). Another reason is that IFRS 7 requires the disclosure of information that should be readily available, because many of the disclosures are based on the views of, and information provided to, key management. In consequence, it is not the technical interpretation of the standard or systematic information-gathering issues that have caused entities the most difficulty when applying IFRS 7 for the first time. Instead, the lack of prescriptive requirements in IFRS 7 seems to have resulted in a degree of confusion about the level of disclosure that might be acceptable and, perhaps, reluctance by entities applying the standard to disclose more detailed information than they feel might be given by their peers (also noted in BDO Stoy Hayward, 2008:4).

Table 8: Quality of quantitative disclosures provided

Quality of quantitative disclosures provided					
		Perfunctory	Standard	Excellent	N/A
Disclosure for:	**Number**	**Number**	**Number**	**Number**	**Number**
Credit risk	20	1	4	10	5
Liquidity risk	20	0	6	4	10
Market risk	20	0	7	7	6
Total	**60**	**1**	**17**	**21**	**21**

Source: Annual report disclosure (own analysis)

The findings in Table 8 indicate that companies that have complied with the disclosure requirement have a strong tendency to provide more information than the bare minimum. Further, these companies were found to steer away from generic quantitative analyses in their disclosures, and instead adequately and comprehensively analyse and explain their risk exposures. The companies achieving excellent ratings generally cross-referenced their disclosure to comprehensive risk management reports elsewhere in the annual report. These companies disclosed entity-specific age analyses that were in line with the company's credit policies, detailed geographical analyses that were clearly sourced from internal information and product-based analyses. One company included an explanation of its internal rating system and provided quantitative disclosures based on its internal rating system. The banking companies included in the population were the leaders in this analysis. This is likely due to the comprehensive reporting systems in place and the significant investment that the banks have made in their reporting systems.

5.3.3 Prescribed minimum quantitative disclosures

Objective of the analysis

For each type of risk arising from financial instruments, an entity shall disclose the disclosures required by IFRS7.36–42, to the extent not provided in accordance with IFRS7.34(a) (IASB, 2009a:para.34(b)). In essence, this requirement is to prescribe minimum quantitative disclosures for credit risk, liquidity and market risk. The objective of this analysis was, firstly, to evaluate compliance with this disclosure requirement (Tables 9, 10 and 11); secondly, to compare the findings in Tables 9, 10 and 11 with those in Table 7 to draw a comparison between adherence to prescribed minimum disclosure and the inclination to provide quantitative data about each risk area based on information provided internally to key management personnel of the entity (Table 12).

The third objective of this analysis was to evaluate the quality of the disclosure provided for this requirement (Table 13) – therefore to deduce the extent of application of the "through the eyes of management" approach with respect to this disclosure requirement.

Findings and deductions

Table 9: Prescribed minimum quantitative disclosures for credit risk

		Yes	No	N/A*
Disclosure for:	**Number**	**Number**	**Number**	**Number**
Maximum exposure to credit risk	20	18	2	0
Collateral held	20	14	4	2
Credit quality of neither past due nor impaired	20	16	3	1
Financial assets renegotiated	20	9	2	9
Total	**80**	**57**	**11**	**12**

Source: Annual report disclosure (own analysis)

Table 10: Prescribed minimum quantitative disclosures for liquidity risk

		Yes	No	N/A*
Disclosure for:	**Number**	**Number**	**Number**	**Number**
Maturity analysis - non-financial liabilities	20	20	0	0
Maturity analysis - financial liabilities	20	12	7	1
Liquidity risk	20	15	3	2
Total	**60**	**47**	**10**	**3**

Source: Annual report disclosure (own analysis)

Table 11: Prescribed minimum quantitative disclosures for market risk

		Yes	No	N/A*
Disclosure for:	**Number**	**Number**	**Number**	**Number**
Sensitivity analysis	20	20	0	0
Methods and assumptions	20	20	0	0
Total	**40**	**40**	**0**	**0**

Source: Annual report disclosure (own analysis)

The findings in Tables 9, 10 and 11 indicate that for all three risk areas the level of compliance within the population is high. For market risk quantitative disclosures, there is a 100% compliance percentage. For credit risk and liquidity risk, taking out the entities in the population for which the disclosure requirements are not applicable, the compliance percentages are relatively high at 84% and 83% respectively. When compared to the findings in Table 7, it is evident that the compliance levels of all three areas are significantly higher for the prescribed minimum quantitative disclosures. The higher level of compliance in the prescribed minimum quantitative disclosures is evidence of the inclination to adhere to prescribed minimum disclosure requirements over the disclosure of management information. This is summarised as follows:

Table 12: Comparison of findings between tables (expressed in percentage terms for compliance)

	Table 7	**Tables**
Credit risk	75%	84% (Table 9)
Liquidity risk	50%	83% (Table 10)
Market risk	70%	100% (Table 11)

Source: Annual report disclosure (own analysis)

Table 13: Quality of prescribed minimum quantitative disclosures for credit risk, liquidity risk and market risk

		Perfunctory	**Standard**	**Excellent**	**N/A**
Disclosures for:	**Number**	**Number**	**Number**	**Number**	**Number**
Credit risk	20	3	9	7	1
Liquidity risk	20	4	11	5	0
Market risk	20	4	10	6	0
Total	**60**	**11**	**30**	**18**	**1**

Source: Annual report disclosure (own analysis)

The findings in Table 13 indicate a more diverse spectrum in the quality of the disclosure. The majority of the entities have provided standard disclosure, with many examples of excellent disclosure. The tendency (18% of the population in this analysis) to provide perfunctory disclosures is concerning in light of the fact that scholarly evidence suggests that the transparency of information associated with measurement and recognition of accounting amounts related to, and disclosure of information about, asset securitisations and derivatives were probably insufficient for investors to assess properly the values and riskiness of affected bank assets and liabilities, which could have contributed to the financial crisis (Barth & Landsman, 2010:401).

5.4 Summative findings

From the research results above it is evident that the “through the eyes of management” approach with respect to accounting policies is not applied as comprehensively as would be expected and required as per the literature. Of the companies in the population that did pay attention to the accounting policies, many did so in a perfunctory nature. The compliance levels for qualitative disclosures for the companies in the population were high. This was followed by a strong tendency to provide more qualitative information than the bare minimum and evidence that the “through the eyes of management” approach was applied by these companies in the population. The comparison of the voluntary quantitative disclosure requirement to the prescribed minimum quantitative disclosure requirement for the companies in the population indicated their inclination to adhere to the prescribed minimum over the disclosure based on management information. This indicated a weaker inclination to apply the “through the eyes of management” approach to the quantitative disclosures in the context of minimum disclosures having been prescribed.

6. CONCLUSIONS

This article set out to provide an overview of the reporting of financial instruments and to investigate the extent to which the “through the eyes of management” approach is applied by selected companies from the JSE Top 40 in their financial instruments disclosure. A literature review comprising the objective and qualitative characteristics of financial reporting, the evolution of financial instruments disclosure, key principles of IFRS 7 and reviews performed on financial instruments disclosure was undertaken. This review highlighted that the accounting for financial instruments was under intense scrutiny and that there were indications that the current practices of financial instrument reporting were not following the “through the eyes of management” approach. The literature review then informed the empirical study of the disclosure practices related to financial instruments in the selected companies.

The study found that in certain respects of the disclosure, the “through the eyes of management” approach was followed, and in other areas, not. The “through the eyes of management” approach was evident in the qualitative disclosures, with many of the companies providing more qualitative information than the bare minimum, while the application of the approach was less evident in the accounting policy and quantitative disclosures. This study focused on selected companies on the JSE, and there are further research opportunities to extend the analysis to other listed companies and smaller entities.

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