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EDITORIAL REVIEW

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Advanced financial reporting—The French approach to the disclosure problem

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Abstract

Sound decision-making depends on an appropriate level of relevant information. This topic is on the agenda of international standard setters in order to increase the decision usefulness of financial disclosures for the addressees of corporate reporting. A look at France demonstrates how a unique recommendation on financial market communication initiated by the Financial Supervisory Authority, which goes beyond legal requirements, can help solve the problem. The resulting advanced disclosures not only provide a clear picture of the origin and magnitude of, for example, financial risks but also of the extent to which the company has reduced or increased the risk with derivative instruments. Such unprecedented transparency could raise the inhibition threshold for speculation. In addition, we illustrate that the enhanced data granularity could benefit various stakeholders through more meaningful competitive or benchmarking analyses.

KEYWORDS

advanced financial reporting | disclosure problem | voluntary reporting

1 | THE PROBLEM

Decision-making requires an adequate amount of information as input variable. In this respect, extant literature indicates that the performance relative to decision-making is positively correlated with the amount of information an individual receives. However, excess information is counterproductive, and the result is a so-called information overload with lower performance of decision makers, that is, lower quality of decisions (e.g., Chewning & Harrell, 1990, O'Reilly, 1980, Schick et al., 1990). In the realm of accounting, information overload in connection with public corporate disclosures, such as annual financial statements, is often termed disclosure problem, where it is important to note that the latter term takes a broader perspective. It does not only cover the overload of data in financial disclosures but rather targets the relevance of the published information (Zülch & Weuster, 2017).

As early as 2003, Paredes expressed his concern that the financial reports were no longer understandable because they had become so full of information (Paredes, 2003). This ongoing discussion gathered momentum during the 2010s when several standard setters, such as the International Accounting Standards Board (IASB), U.S. Securities and Exchange Commission (SEC), and the European Securities and Markets Authority (ESMA), were internationally addressing this problem with the objective of solving the issues of information overload and disclosure problem. In 2013, the IASB provided survey evidence that more than 80% of the survey participants agree that the way financial information is disclosed could be improved. Furthermore, the results indicate that, instead of letting users search large amounts of data, the communication of relevant information in the financial statements needs to be revised (IASB, 2013). In the same year, the SEC Chairwoman, Mary Jo White, also expressed concern about investors facing an information overload and mentioned that public companies should streamline their disclosures (Lynch, 2013). The IASB Chairman's initiative to prioritize the communication effectiveness and improve the quality and usefulness of financial disclosures is another example of the seriousness and topicality of the problem (IASB, 2016).

2 | ALTERNATIVE REPORTING

Several studies show that simply reducing the scope of annual reporting is not enough for users of financial statements: While a reduction in the length of annual reports increases clarity, it does not increase the decisive benefit for the addressees: its decision usefulness (Zülch & Weuster, 2017). Regarding the prevailing lack of relevant information, a look at the unique regulatory environment in France may contribute to a solution.

What is so unique about the regulatory environment in France? As optional supplement, the Autorité des Marchés Financiers (AMF), supervisor of the French financial markets, has established a so-called "registration document" that favors advanced disclosures and that is intended to provide additional information about the company's business, financial position, earnings, and prospects for various stakeholders. In terms of, for example, financial risks, the AMF provides, in position paper n° 2009-16, detailed guidance (Autorité des Marchés Financiers, 2009) on advanced and extended corporate disclosures concerning the management of foreign currency risks that go far beyond the applicable reporting standards of IFRS 7.33 and 7.34. Exhibit 1 illustrates the recommended format by the AMF, including an exemplary numerical currency position.[1]

Exhibit 1 shows that the regulating authority advises companies to state their actual exposure before and after management by year and currency at the reporting date, as well as the composition of the risk from assets, liabilities, and forecasted transactions. Following the proposal of the AMF, companies typically specify their exposed assets and liabilities (columns [a] and [b] in Exhibit 1, mostly in the form of FX-receivables and FX-payables), combined with estimated forecasted positions (column [c]). Overall, these figures result in a firm-, year-, and currency-specific exposure before hedging (column [d]). In addition, companies provide information on the corresponding hedged amounts (column [e]), as well as the resulting net exposure after hedging (column [f]). The entire information is usually provided for each year and currency on the balance sheet date.

The numerical example demonstrates the unique data granularity once more: For example, a company reports 120 units of FX-assets and 30 units of FX-liabilities in a particular currency. These are completed with forecasted FX-sales of 20 units and forecasted FX-purchases of 10 units, which lead to an exposure before hedging of 100 (120 − 30 + 20 −10 = 100) units. Exemplarily, the companies hedges 50 units of this exposure and hence reports an exposure after hedging of 50 units. Exhibit 2 shows an example of a published FX risk management report from France.

The disclosure of the exposure before and after hedging per currency gives the reader a profound overview of the origin and extent of the risks to which a company is exposed at the balance sheet date. It also illustrates which specific hedging measures have been taken, that is, to what extent the risk has been reduced or increased with derivative instruments.

For comparison reasons, Exhibit 3 shows an exemplary FX risk management reporting of a German DAX

EXHIBIT 1 **Guidelines Autorité des Marchés Financiers.**

Year	Assets [a]	Liabilities [b]	Forecasted exposure [c]	Exposure before hedging [d] = [a] − [b] + [c]	Hedging instruments [e]	Exposure after hedging[f] = [d] + [e]
Currency 1	120	30	10	100	−50	50
Currency 2						
Currency *n*						
Total						

Source: Autorité des Marchés Financiers (2009), Position - recommandation AMF n ° 2009-16: Guide d'élaboration des documents de référence.

EXHIBIT 2 Exemplary presentation of a published FX risk management report of a French company. Source: Kering SA, Registration Document 2018.

As of December 31, 2018, the exposure to foreign exchange risk on the statement of financial position was as follows:

(in € millions)	Dec. 31, 2018	USD	JPY	GBP
Monetary assets	3,494.7	883.2	281.0	337.3
Monetary liabilities	988.4	438.4	396.6	9.5
Gross exposure in the statement of financial position	2,506.3	444.8	(88.6)	327.8
Forecast exposure	3,559.4	1,247.2	472.8	384.5
Gross exposure before hedging	**6,065.7**	**1,692.0**	**384.2**	**712.3**
Hedging instruments	(5,394.9)	(1,623.6)	(716.5)	(630.6)
Gross exposure after hedging	**670.8**	**68.4**	**(332.3)**	**81.7**

EXHIBIT 3 Exemplary risk management report of a German DAX company for the currency risk. Source: Beiersdorf AG, Annual Report 2018.

CURRENCY RISK

The fair value of the currency forwards at the balance sheet date was €–3 million (previous year: €0 million), and their notional value was €1,860 million (previous year: €1,741 million). As in the previous year, all of the forward contracts have a remaining maturity of up to one year. The notional values represent the aggregate of all purchase and selling amounts for derivatives. The notional values shown are not netted.

If the euro had appreciated by 10% against all currencies as of December 31, 2018, the fair values of the currency forwards recognized directly within the hedging reserves in equity would have increased by €49 million (previous year: €55 million). If the euro had depreciated by 10%, the fair values of the currency forwards recognized directly within the hedging reserves in equity would have decreased by €65 million (previous year: €68 million). An appreciation or depreciation of the euro would not have a material impact on the consolidated financial statements when valuing currency forwards recognized in profit and loss. This is because the resulting changes in the hedged items would compensate for the effects of any changes in the market values.

company, one of the most important risks for German companies. The data granularity provided by U.S. companies is similar, as Exhibit A1 illustrates. We can see that the reporting covers the fair value of all currency forward transactions (as an evaluation parameter for the balance sheet), their total nominal volume (long and short combined), and their residual maturity. Furthermore, a sensitivity analysis indicates potential effects of exchange rate fluctuations on the income statement.

The significantly higher information content and level of detail of the French reports is far from being reached. Instead of the quantitative indication of the risk before and after hedging per currency, the company merely states that forward transactions with a total nominal volume of 1,860 million Euros have been concluded, but this is a composite total of purchase and sales contracts, i.e., opposing long and short positions. The underlying risk managed with these forward transactions is not communicated, that is, the company does not disclose the actual extent of the currency risks to which it is exposed at the end of the reporting period, nor are the currencies concerned. An evaluation of the hedging measures taken is not possible based on these data, but it does comply with the specifications of IFRS 7.33 and 7.34.[2]

With regard to the intended increase in the usefulness of financial disclosures under the initiative of the IASB Chairman, the comparison clearly shows the enhanced decision usefulness for the addressees of annual reports. In addition, several studies indicate further benefits for various stakeholders.[3] As the extant literature shows, derivative financial instruments are used for both risk-decreasing (hedging) and risk-increasing (speculative) purposes. While the French risk management reporting enables the reader to examine whether derivative financial instruments have been used for hedging or speculative motives, the German or U.S. reports leave the reader in the dark in this respect.[4] Furthermore, speculative intentions to generate additional profits has often led to endangering corporate losses in the millions and billions (Poitras, 2002). The increased transparency stemming from the French reporting could also raise the inhibition threshold for speculation and could thus prevent imperiling corporate losses from derivative transactions. Overall, such a proactive financial communication, which goes beyond the statutory requirements, creates trust and credibility among shareholders and various stakeholders.

In order to substantiate our results with professional judgment, we interviewed four treasury executives of major German companies, including two DAX 30 companies. Further to the above, the treasury executives indicated that such an enhanced data granularity could also benefit financial analysts, shareholders, or potential investors through more meaningful analyses. In addition, the interviewed practitioners stated that such an information base would enable companies to carry out unprecedented competitor analyses and thereby benchmark and improve their own risk management.

3 | CONCLUSION

Effective decision-making not only requires an appropriate amount of information but also an adequate level of relevant data. The example of the unique regulatory environment of France with its alternative reporting model shows that the supervisor of the French financial markets is committed to providing more relevant information to the various addressees of corporate reporting. Along with the demonstration that the approach from France increases the decision usefulness for the addressees, we also illustrate that the new reporting entails numerous benefits for several stakeholders. In summary, we demonstrate that the various financial supervisory authorities and standard setters of financial reporting could gain useful insights to tackle the issues of information overload and disclosure problem from the French reporting model.

ENDNOTES

[1] The original document is in French language and not available in English.

[2] With respect to risk management reporting, IFRS 7.33 and 7.34 require accounting entities to provide a qualitative and quantitative description of the nature and extent of financial risks arising from financial instruments. For the qualitative description (7.33), this includes both the extent and the origin of the risk exposures, as well as the “management's objectives, policies, and processes for managing those risks.” In quantitative terms (7.34), “summary quantitative data about exposure to each risk at the reporting date” must be disclosed.

[3] For example, Hecht, 2019 (https://www.emerald.com/insight/publication/issn/1526-5943/vol/20/iss/5) or Hecht & Lampenius, 2018 (https://ssrn.com/abstract=2987901).

[4] While the literature is in agreement that investors are unable to identify speculation by analyzing publicly available data (Géczy, Minton, & Schrand, 2007), the new data granularity provided by French companies allows, henceforth, speculative activities to be identified based on public corporate disclosures (Hecht, 2018, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3001668).

DATA AVAILABILITY STATEMENT

Data sharing is not applicable to this article as no new data were created or analyzed in this study.

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APPENDIX A.

EXHIBIT A1 Exemplary risk management report of a S&P 500 company for the currency risk. Source: Walmart Inc., Annual Report 2018.

Foreign Currency Risk

We hold currency swaps to hedge the currency exchange component of our net investments and also to hedge the currency exchange rate fluctuation exposure associated with the forecasted payments of principal and interest of non-U.S. denominated debt. The aggregate fair value of these swaps was in an asset position of $413 million at January 31, 2018 and a liability position of $147 million at January 31, 2017. The change in the fair value of these swaps was due to fluctuations in currency exchange rates, primarily the strengthening of other currencies relative to the U.S. dollar in fiscal 2018. A hypothetical 10% increase or decrease in the currency exchange rates underlying these swaps from the market rate at January 31, 2018 would have resulted in a loss or gain in the value of the swaps of $560 million. A hypothetical 10% change in interest rates underlying these swaps from the market rates in effect at January 31, 2018 would have resulted in a loss or gain in the value of the swaps of $22 million.