**Investor view**

*Insight from the investment community*

**Why is use of clear language important in financial statements?**

Investors often tell us they don’t necessarily want more information in financial statements but more useful information. They cite among their frustrations boilerplate accounting policies and a lack of useful commentary in the notes. In this ‘Investor view’, we look at the investors’ concerns and simple ways entities can address them.

We all know that there is some jargon inherent in financial reporting. But as many investors are not technical accountants, it can cause them some confusion.

If management can get ‘back to basics’ and explain the underlying economic substance of the accounting in the financial statements, it would significantly help investors in trying to analyse the entity’s performance.

**Accounting policies**

Boilerplate accounting policies are not generally helpful to investors. What they really want is a clear picture of:

- the accounting policies that are critical for the entity;
- what the accounting policies really mean for the entity – for example, rather than saying ‘revenue is recognised in accordance with IFRS’, investors want an explanation of how management recognises revenue for its various products and services (such as contract payments upfront versus over time) and how that impacts revenue for the period; and
- unambiguous statements – clear and concise descriptions in the relevant accounting policies.

An example of good accounting policy disclosure is in ICAP plc’s financial statements. This financial services company has moved its accounting policies to be alongside the relevant note to the financial statements.

**Commentary in the notes**

Investors tell us that key messages can get buried in some of the notes to the financial statements. Share-based payments, pensions, financial instruments and hedging notes are the most commonly cited examples.

In addition to complying with IFRS, management could make a few simple improvements that would really help
investors with these complex disclosures:

- Top and tail the notes with meaningful commentary about what the numbers mean for the business. For example, a hedging note could be made more accessible for investors by making clear what has and hasn’t been hedged, at what price and for how long.
- Explain the numbers in the note in the context of the business. For example, is the pension scheme deficit material to the group? Could it ever be? This will help the investor to focus on the key areas of the accounts.
- Point investors to the headline items. What is the key message they need to understand from the accounts? Where are the areas of risk? Where are the notes that really reflect the key metrics of the business?
- Link clearly from the management commentary to the notes. For example, ‘If you look at note X, you will see Y. This is because Z happened this year.’

We are seeing an increasing number of companies make improvements to the commentary in their financial statements. One good example is UK asset manager Schroders plc. Schroders has:

- positioned the relevant accounting policy with each note;
- introduced a clear description of the purpose of each note;
- moved the relevant sections of the financial review alongside the financial statements; and
- used ‘bridge charts’ to explain the drivers behind the changes in key financial numbers.