

Incomplete Disclosure of Financial Statements: A problem to be eliminated.¹

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ABSTRACT

The study aim is to analyze the problem of incomplete financial statements disclosure by Brazilian companies. The examples of financial statements show an incomplete disclosure. The companies do not publish all the mandatory statements, show few informations, use small characters and omiss important information. As a solution for this issue, I proposed to create a standard for the publication of financial statements by electronic means (Balance Sheet Central).

KEYWORDS

Financial
Statements;
Disclosure;
Accounting.

PRACTICAL INSIGHTS

The accounting information users should pay attention on the standard and quality of reports published by companies. Even with the adoption of international accounting standards there is still a huge discrepancy between the information required by the accounting standards and what companies do, even among companies in the same industry. Thus, my proposals presented here aim to offer users an clear information sharing environment. My purpose is improving the communication process by adopting a technical standard that contemplates the faithful representation of the economic facts. In this way, we could improve the accountants and accounting information appreciation.

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1. INTRODUCTION

In recent years, it is usual to find the disclosure of incomplete financial statements of large and medium-sized firms in major newspapers specializing in economic and financial matters. This problem is relevant because...

*... the publication of incomplete (or imperfect) accounting information is harmful to users, as it may lead to **wrong analyzes and poor decisions**, since the disclosure of partial information can be potentially misleading..*

Notably, the incomplete disclosure creates asymmetrical information between companies and the external users, by allowing an economic agent to have better qualitative and quantitative information in a transaction with another economic agent.

It is important to point out that for international and national regulators the disclosure of a useful accounting and financial report is important for the adequate functioning of capital and credit market.

In this context, according to the Brazilian Accounting Standard Board (CPC), in order that the accounting and financial information is useful to investors and creditors in decision-making linked to the supply of resources to the entity, they must present some essential characteristics, namely: (a) relevance; and (b) faithful representation of the depicted economic reality.

Just to remember, the Brazilian Accounting Standard Board explicitly states that:

Reporting financial information that is relevant and faithfully represents what it purports to represent helps users to make decisions with more confidence. This results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. An individual investor, lender or other creditor also receives benefits by making more informed decisions. However, it is not possible for general purpose financial reports to provide all the information that every user finds relevant. (QC37 CPC 00)

In this context, our goal is to analyze the problem of incomplete disclosure of financial statements by private companies in Brazil and propose ways to resolve this issue.

In what follows, I briefly explain the nature of the deficiencies mentioned as well as the applicable law, then present some suggestions to solve this issue, which is of interest to society in general, and of the capital and credit markets specifically. Finally, I present some final considerations.

2. UNDERSTANDING THE PROBLEM

Figures 1 and 2 show two examples of incomplete disclosure of financial statements published in a major newspaper. These examples omit relevant information such as: (a) cash flow statements, statements of changes in equity and other additional statements; (b) notes to the financial statements; (c) the independent auditor statement; and (d) the management's discussion and analysis report (MD&A).

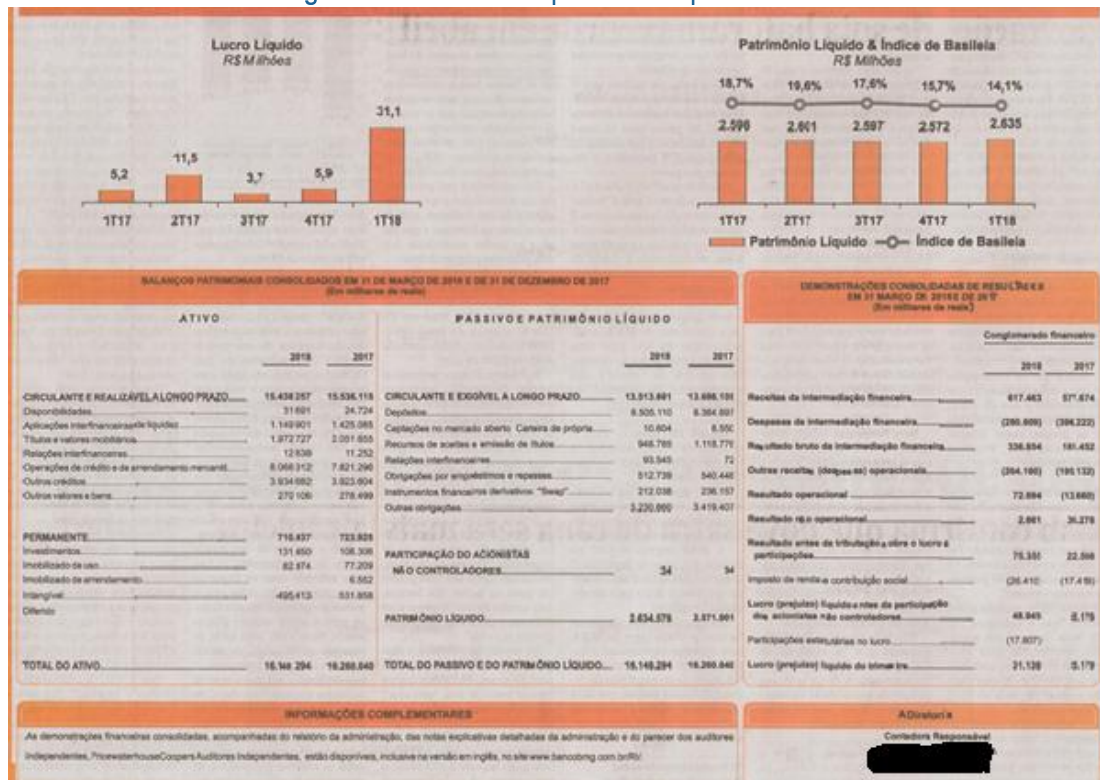
Note that these two selected examples contain only the Balance Sheet and the Income Statement, and the second example seems to focus more on the chart itself. According

to the corporate legal nature of these companies, publications should not only include the statement of cash flows but also be accompanied by explanatory footnotes and the report of independent auditors.

Figure 1 - First example of incomplete disclosure

PARTICIPAÇÕES S.A.					
CNPJ Nº [REDACTED]					
Balanco Patrimonial Encerrado em 31/12/2016 e 2017					
Ativo	31/12/2016	31/12/2017	Passivo	31/12/2016	31/12/2017
Circulante	19.112.211,21	173.108,82	Circulante	1.986.486,44	467,42
Disponibilidades	219.723,48	173.108,82	Fornecedores	219.866,63	-
Caixa	1,00	1,00	Adiantamento de Clientes	1.117.386,06	-
Bancos Conta Movimento	1,00	1,00	Obrigações fiscais	60.191,75	467,42
Aplicações Financeiras-Curto Prazo	219.721,48	173.106,82	Não Circulante	3.691.642,48	200.664,40
Outros Créditos	18.892.487,83	-	Partes Relacionadas - LP	3.601.642,48	200.000,00
Partes Relacionadas	1.273.731,50	-	Patrimônio Líquido	271.138.336,43	269.338.628,70
Dividendos a receber	17.614.542,45	-	Capital Social	195.085.085,78	269.362.188,30
Adiantamentos Diversos	4.213,88	-	Reservas de Lucros	195.085.085,78	269.305.188,36
Não Circulante	257.922.224,10	269.266.985,30	Reserva legal	5.290.229,56	(85.561,60)
Realizável a Longo Prazo	8.959,63	-	Reserva de Lucros	100.640.536,06	1.831.146,20
Outros Valores a Receber	8.959,63	-	Prejuízos acumulados	(29.885.508,91)	(1.366.708,60)
Depósitos Judicial	8.959,63	-	Lucros Acumulados	(29.885.508,91)	-
Permanente	257.913.264,47	269.266.985,30	Resultado do Exercício Atual	(29.885.508,91)	-
Participações em Controladas	257.912.479,21	269.266.985,30	Total do Passivo	278.134.435,41	269.440.294,12
Imobilizado	788,28	-			
Valor Original	9.350,00	9.350,00			
Depreciações Acumuladas (-)	(8.570,34)	(8.559,00)			
Total do Ativo	276.134.435,41	269.440.294,12			

Figure 2 - Second example of incomplete disclosure



Notes: (1) Statements published in Valor Econômico newspaper of May 4, 2018 (section A5 and C1, respectively).

Notably, many companies choose to publish overly **synthetic and incomplete financial statements** in major newspapers. To make matters worse, it is also common to see that some companies **do not indicate where they keep the complete version of the financial statement**, just saying that the statement is available for inspection at the company's headquarters.

In fact, there are many other different types of incompleteness such as:

- a. disclosure of the names of the independent auditors firm without the auditors' opinion statement;
- b. incomplete footnotes; and/or
- c. extremely short MD&A report.

In addition to that, there are complete publications with such **small characters** that it makes the content of the financial statements rather unreadable.

Finally, another very problematic situation occurs when there is a publication of just **part of financial statement that was rectified**, without a full reprint of information. In this case the publication of the rectification is totally inadequate and, of course, useless for users.

3. CURRENT AVAILABLE RULES

Law # 6.404/1976 applicable to public listed companies, which requires the publication of these financial statements, which should **express clearly the company's situation and the changes occurred in the year** (Article 176.): (I) balance sheet; (II) statement of retained earnings; (III) profit and loss statement; (IV) the cash flow statementⁱ; and (V) value added statement, if the company is listedⁱⁱ.

This law also states that the statement will be supplemented by **explanatory footnotes and other analytical frameworks or financial statements** necessary to clarify the financial situation and results of the year. In addition, indicates a minimum items that should be included in the notesⁱⁱⁱ.

The Brazilian Corporate Law requires the publication of the financial statements in the Federal Register or the State Register, and in a newspaper of general circulation in the company's headquarters location filing them with the Commercial Registry. In addition, companies can make the financial statements available on the Internet. Finally, companies registered with the Brazilian Securities and Exchange Commission are required to submit their Financial Statements (DFP), as set by Instruction CVM # 202/1993 (item I of Article 16)^{iv}.

For private companies, which follow the Civil Code (Law # 10.406/2002), which provides that at the end of each fiscal year companies will prepare up the inventory, the balance sheet and the balance of economic output. These financial statements will be used in a shareholder meeting, which must be held at least once a year, as defined in articles 1.065 and 1.078.

Art. 1188. The balance sheet should express with fidelity and clarity, the actual situation of the company and, observe its peculiarities, and the provisions of special laws, indicating assets and liabilities distinctly.

Single paragraph. special law shall provide the information that will accompany the balance sheet for affiliated companies.

Art. 1,189. The balance of economic output, or statement of profit and loss account, will accompany the balance sheet and it shall include credit and debit, according to the special law." (Free translation)

Law # 8,666/1993, which lays down rules for bidding and contracts with the Government, states that stakeholders documentation relating to economic and financial qualification will be required, as described below: "balance sheet and financial statements for the last fiscal year, as required and presented to the law, proving the good financial condition, sealed its replacement by balance sheets or interim balance sheets, which may be adjusted based on official indexes when closed for more than three (3) months from the date of submission of the proposal" (free translation from article 31).

Law # 8,987/1995, which deals with concession contracts and public services permission, also requires that the concession agreements demand the publication of financial statements of the operator (item XIV, article 23). In this sense, Resolution ANATEL # 678 of 6 June, 2017, for example, establishes that the concession agreements shall contain the following clause:

XXVIII - publish annually, regardless of the corporate legal system to which it is subject to, balance sheet and financial statements at the end of each fiscal year, following the provisions of applicable laws and regulations issued by Anatel; (free translation)

Finally, Law # 11,101/2005, which set judicial recovery, extrajudicial and bankruptcy of the entrepreneur and the business company, states that the application for judicial recovery is necessary to the financial statements for the three fiscal years, made in strict compliance with the applicable corporate law, and must include: (a) Balance sheet; (b) Accumulated results statement; (c) Statement of income from the last fiscal year; and (d) Cash flow management report and its projection (section II of article 51).

In this topic you can see that

*(a) the **requirement** for preparation of financial statements is **not homogeneous**, varying according to the legal nature of the business company;*

*(b) the **publication requirements** are **different** and the result of different motivations, creating a variety of situations; and*

*(c) companies are required **to publish** their financial statements in a major newspaper, not being allowed to replace it by a **publication on the Internet**.*

4. A PROPOSAL

demands for the publication of the financial statements in printed major newspapers.

Apparently, some companies choose incomplete disclosure of financial statements to **reduce their publishing costs** at the expense of a quality disclosure intended for external users, without failing to meet legal requirements.

So, it seems, the **solution to the problem** presented goes through two complementary initiatives: (1) changing the law to **allow the publication of financial statements on the Internet** instead of the print publication in major newspapers; and (2) developing a **public electronic platform** to serve as a repository for published financial statements.

Regarding the first proposal, there are some parliamentary initiatives that have not been appreciated and should be analyzed by legislators, highlighting:

a) Bill # 243/2008 - Proposal for Senator DEM/DF:

Art. 1 Art. 3 of Law No. 11,638, of December 28, 2007, shall read as follows:

§ 2 The companies mentioned in the caption of this article publish their financial statements in major newspaper and, optionally, on the World Wide Web at sites accredited by the Boards of Trade or by the Securities and Exchange Commission. (Free translation)

b) Bill # 5,061/2013 - Proposal for State Representatives from PR/RJ:

It is proposed to amend Article 289 of Law 6,404/1976:

(A) publications carried out by companies, due to requirements of the Corporate law, should be available on the Internet; and

(B) publications required by The Brazilian Corporate Law should be filed with the Commercial Registry, which shall also make them available on the Internet. (Free translation)

These bills, filed in 2015, proposed to use the internet as a means of financial statements disclosure, helping to reduce publishing costs and increasing corporate transparency. These initiatives can contribute to the solidity of the Brazilian economic system as well as prevent further damage to the environment by reducing paper publications.

The second proposal recommends the creation of a public and standardized database, which would serve as a repository of financial information, such as the Brazilian System of External Disclosure (DIVERT) developed in partnership with the local Securities Exchange Commission and Stock Market.

It should also be recommended that this database be built with funds from the Brazilian Federal Accounting Council, which would be responsible for managing and overseeing the information filed in partnership with other regulators.

In this sense, it is important to highlight two complementary initiatives.

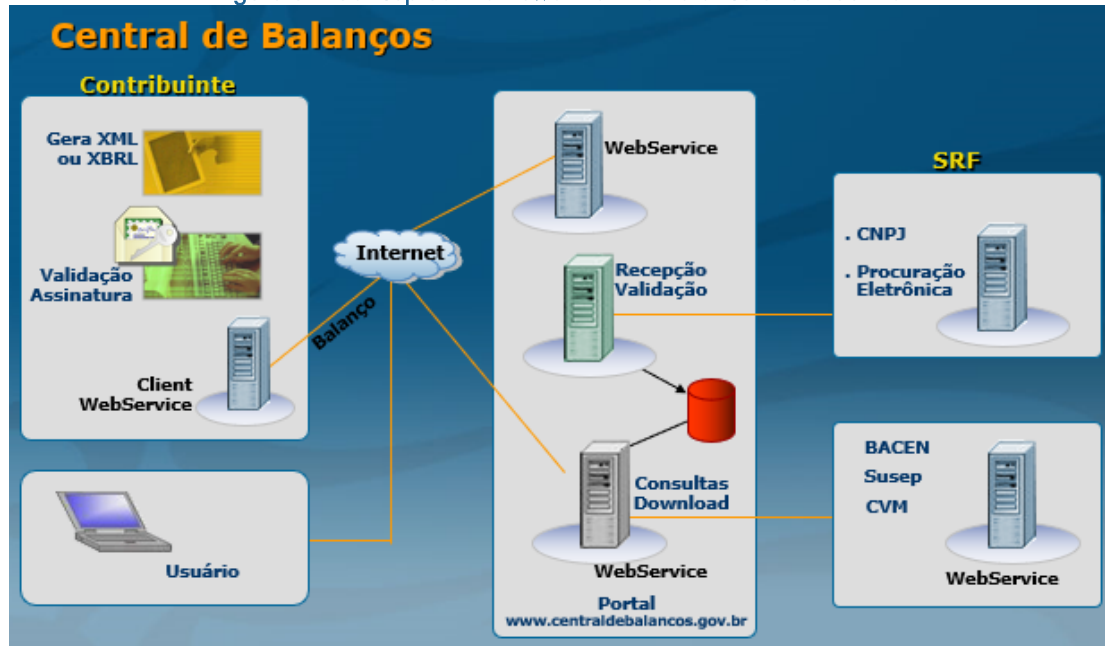
The Brazilian Federation of Banks developed a Balance Sheet database to host the monthly, semi-annual and annual financial statements of banks and other financial institutions, with an exclusive repository of balance sheets (available on <https://centraldebancos.febraban.org.br/>). It is important to remember that the integrity of the financial statements filed is the responsibility of the financial institutions themselves.

The Federal Revenue Service, through Decree # 6.022 of January 22, 2007 established the Public Digital Bookkeeping System (SPED) comprising of accounting and fiscal bookkeeping in standard digital format. In general, SPED consists of seven major sub-projects comprising: (a) Digital Bookkeeping (ECD); (B) Digital Tax Bookkeeping (EFD); (C) electronic invoice (NF-e); (D) Electronic Invoice Services (NFS-e); (E) Electronic Bill of Electronic Transport (CT-e); (F) E-Lalur; and (g) Balance Sheet Center^v.

Basically, Balance Sheet Central aims to organize the companies' financial statements and other economic and financial information in a public digital environment, enabling searches with various levels of aggregation. Although this project is still in

study stage, the initial idea is to get the information of all companies that are obligated to disclose their financial statements and allow voluntary compliance from others.

Figure 3 - Conceptual framework of the Balance Sheet Central



Source: Presentation on the IRS Public Digital Bookkeeping System on November 30, 2006. Available at www.receita.fazenda.gov.br/publico/Sped/Sped30nov06.ppt. Accessed on March 11, 2018. Notes: SRF is similar to IRS, BACEN is similar to FED, CVM is similar to SEC in the US, respectively.

Notably, these two initiatives seek to create faster access to the full financial information, with a corresponding reduction in costs of collecting, storing and processing of information. Of course, the sharing of such information can be very helpful to reduce the redundancies of information requests by various regulatory agencies, and can benefit other users of financial information, such as shareholders, creditors, investment analysts, and credit rating agencies, as well as academics.

4. FINAL REMARKS

Although there is no doubt about the importance of proper disclosure of financial statements, it is observed that companies are publishing deficient accounting statements and, in some cases, not complying with existing rules. Moreover, it is observed that government accounting regulation also fails to promote adequate transparency of accounting information through effective and efficient standards.

While the purpose of the disclosure of financial statements is to provide useful information for users' decision-making, the main issue is to define how much information should be disclosed to maximize its usefulness.

At this point, it is worth remembering a few basic concepts. According to Hendriksen and Van Breda (2015, p. 515), three disclosure concepts are commonly used to secure the desired level of disclosure to help users of financial statements to make decisions in the best way. The first one is the **Adequate Disclosure**, setting a minimum amount of information to prevent the financial statements to be misleading. The second is the **Fair Disclosure** requiring the equal treatment of potential users. The third is the **Full Disclosure**, which requires the disclosure of all relevant information.

These authors also state that the disclosure of significant accounting policies, in which the financial statements are based on, is therefore necessary so that the demonstrations can be properly understood. (Hendriksen and Van Breda, 2015, p. 514)

Specifically, the Brazilian Accounting Standards Board, as well as International Accounting Standard Board, sets **relevant financial information** as “capable of making a difference in the decisions made by users” (CPC QC6 Item 00). Also noteworthy is that the information is **material** “if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity” (Item QC11). Finally, it states that the **faithful representation** requires that the reality depicted in the accounting and financial reporting is complete, neutral and free from error (Item QC12).

Notably, materiality depends on the nature and/or magnitude of the items in the financial reporting of a particular company in a particular context. Thus, due to the subjectivity inherent to the process, it may be a problem to specify a uniform quantitative limit on materiality or which would be deemed material for a particular situation.

It is a fact that, although there is no consensus on the appropriate level of disclosure of financial information, their incomplete disclosure is potentially harmful to users of the information. Thus, the recurrence of incomplete disclosures can be an indication of a failure in the market system, which would justify a specific government intervention by use of new regulations to ensure the disclosure at a minimum acceptable standard.

Obviously, the solution to the problem addressed involves a review of the legislation, which should make disclosure more flexible, by allowing the disclosure of financial information through the Internet, and the development of a specific policy guidance by the Federal Accounting Council, defining a minimum standard for disclosure. Creating a benchmark would also increase the comparability of the information and also make the understanding of this information easier to the users.

As discussed previously, it is expected that a more efficient use of accounting information would be achieved from gathering financial statements in a comprehensive internet database repository.

The Brazilian System of External Disclosure (DIVERS) and the aforementioned balance sheet centers should be very useful references for the construction of a public and standardized database, the result of a comprehensive project that could be implemented and supervised by the Brazilian Federal Accounting Council.

The government agencies could also contribute significantly in this process by providing financial support for the development of a Balance Sheet Central project, in partnership with the Brazilian Federal Accounting Council. For example, government banks could formally require, in their loan agreements, that the financial statements

should be filed in Balance Sheet Central. In return, the main benefit of this initiative would be the improvement of the recovery, process and analysis of such data for lending purposes and other applications.

Despite the implementation difficulties of these proposals, the benefits they bring can go far beyond what we can measure objectively. The main expected benefits of these initiatives are: (a) reduced costs not only of companies' publication but also in the collection and processing of information by the users; and (b) higher transparency in accounting and financial information from businesses to society.

Finally, it is undeniable that, indirectly, this initiative contributes to the enhancement of accounting information and a higher appreciation of the accounting professional.

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- ⁱ The private company with shareholders' equity at balance sheet date, less than two million reais will not be required for the preparation and publication of the statement of cash flows (§ 6).
- ⁱⁱ Amended by Law # 9,457/1997.
- ⁱⁱⁱ Included by Law # 10,303/2001.
- ^{iv} The Brazilian Corporate Law provides that each year, in the first four months following the end of the fiscal year, there should be a general meeting to assess management accounts, examine, discuss and vote on the financial statements. A copy of the financial statements should be made available by the company until one month before the date set for the annual general meeting. (See articles 132 and 133 of Law # 6,404/1976)
- ^v See also Normative Instruction RFB # 787/2007, establishing the Digital Bookkeeping; Resolution CFC # 1,020/2005 approving the NBC T 2.8 - Das Formalities of Bookkeeping in Electronic Form; and Technical Press Release CTG 2001 (R3) of August 23, 2017, issued by the Brazilian Federal Accounting Council.