Agenda item 4. The role of disclosure in risk assessment and enhancing the usefulness of corporate reporting in decision-making

Introductory remarks

Presented by

Amir Amel-Zadeh
Associate Professor, University of Oxford
UNCTAD resource person

This material has been reproduced in the language and form as it was provided. The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.
Item 4: The role of disclosure in risk assessment and enhancing the usefulness of corporate reporting in decision making

2 November 2017

Dr Amir Amel-Zadeh, Saïd Business School
University of Oxford
Disclosure of high-quality information is critical for functioning of capital markets

Stewardship of resources

Asymmetric information & agency problems

High-quality disclosure

Required return & risk considerations

Investment decisions

Firms

Capital providers

Capital

ISAR 34, Item 4, Amir Amel-Zadeh
Assessing risks plays central role in capital allocation

### Business

- Variability of profits stemming from:
  - Changes in customer preferences
  - Competition
  - Technological and socio-economic factors
  - Business model changes
  - Product and services
  - Human resources and intellectual capital

### Financial

- **Solvency**: inability to meet long-term financial obligations
- **Credit**: potential default of borrower/customer
- **Liquidity**: inability to pay short-term obligations
- **Market**: fluctuations in asset prices
- **Macroeconomic**: economic cycles, interest rates and inflation

### Non-financial

- **Operational**: errors and malfunctions, failure in logistics, attacks (cyber, terrorism-related)
- **Political**: changes in policies and regulations, sanctions, conflict
- **Environmental**: natural disasters, severe weather, climate change
- **Social**: employee health, boycotts, strikes, reputation
- **Governance**: leadership and oversight failures
Risk reporting varies widely

**Disclosure requirements**
- Securities regulation & company law
- National and international reporting standards
- Stock exchange listing requirements
- Sector-specific regulations
- Recommendations by international organizations
- Voluntary disclosures

**Characteristics**
- Quantitative ↔ Qualitative
- Separate ↔ Embedded
- Narrative ↔ Financial statements
- Specific ↔ Generic

**Examples**
- Management commentary (IASB)
- MD&A (SEC)
- Disclosure Guidance (FCA)
- Hedging (FASB)
- Risk factor disclosure (SEC)
- Companies Act (UK)
- Pillar 3 (BIS)
- Principal risks in reports (EU)
- Sustainability (Stock exchanges)
- Climate risk (TCFD)
Users and preparers of risk disclosures face several challenges in the current environment

**Challenges for users**
- Disclosure varies in quantity, quality and location
- Often generic and boilerplate language
- Lack of focus on material risks
- Lack of comparability and reliability
- High costs of extracting relevant risk information

**Challenges for preparers**
- Requirements are sometimes ambiguous
- Trading off comprehensiveness and conciseness/materiality
- Difficult to measure certain risks
- Element of subjectivity
- Flexibility vs. comparability
- More detailed disclosures might be seen as larger risk exposure
- Confidentiality
Risk disclosures can provide complementary, forward-looking information to mostly historical financial statement numbers.
Issues to discuss

- What are the main challenges in establishing harmonized standards for risk disclosure?
- What needs to be done to better align risk disclosures in financial statements and narrative reporting?
- What is the optimal level of disclosure that can balance costs and benefits?
- Is consistency required between disclosures for financial and nonfinancial information?
- Should risk disclosure requirements take into consideration specific challenges of large private companies, SMEs and the public sector, as well as companies operating in developing countries and countries with economies in transition?
- How can global forums such as ISAR further contribute to consensus-building on the topic of risk disclosure?