Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR)

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Afternoon Session

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

Introductory remarks

Presented by

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ISAR 34

Item 4: The role of disclosure in risk assessment and enhancing the usefulness of corporate reporting in decision making

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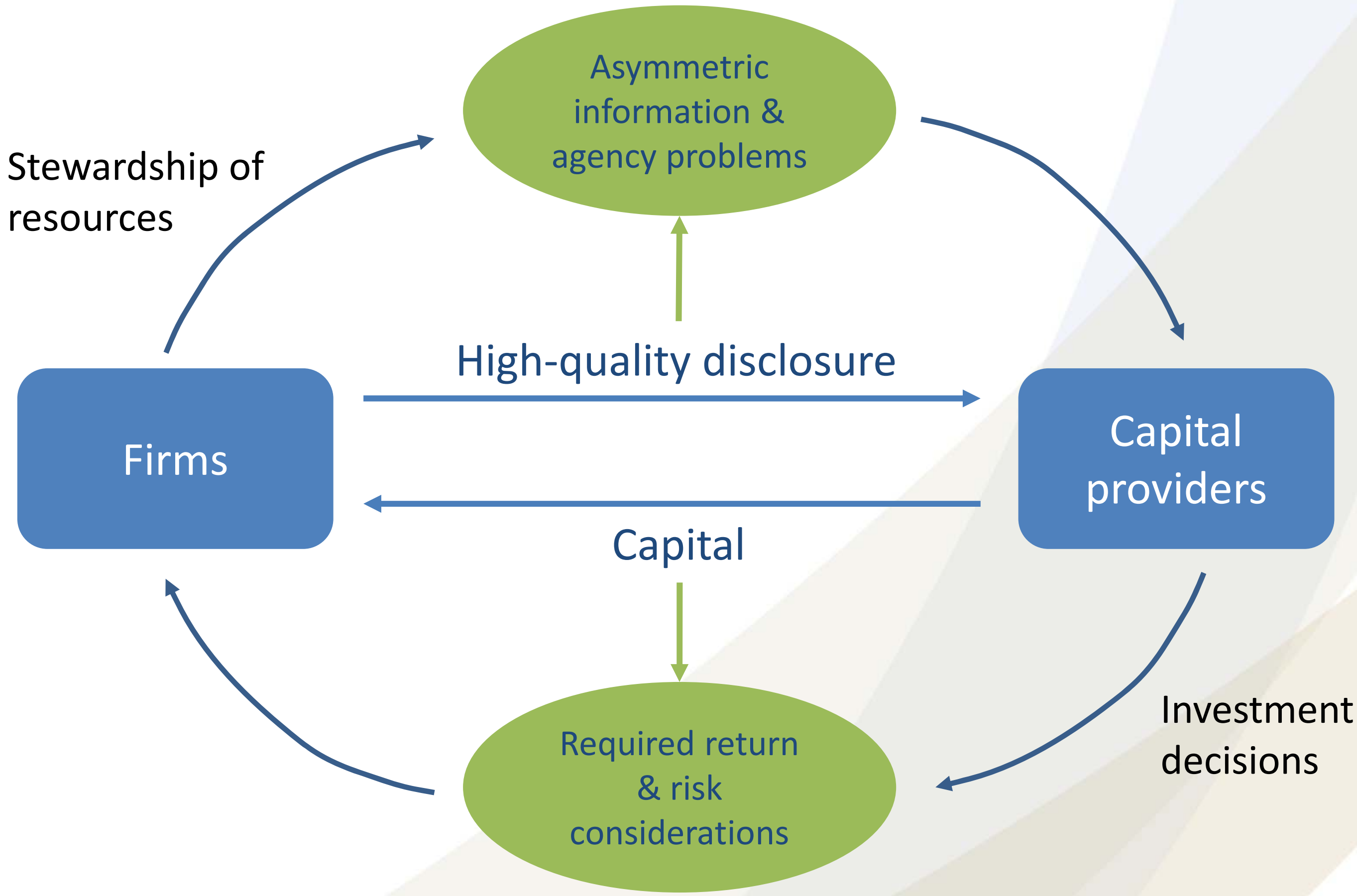
Disclosure of high-quality information is critical for functioning of capital markets



Assessing risks plays central role in capital allocation

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

Risk Disclosure

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

International projects aim to improve the usefulness of disclosures: several recommendations emerge

- What are the most material principal and emerging risks?
- What is the magnitude of the risk exposure?
- How are the risks managed?

Risk Disclosure → Materiality
Risk Disclosure → Structure & readability
Risk Disclosure → Comparability

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?

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